

POLICY DEBATES

Assessing the Canada-U.S. Free Trade Agreement

Edited by
MURRAY G. SMITH
and
FRANK STONE

The Institute for Research on Public Policy
L'Institut de recherches politiques



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P O L I C Y D E B A T E S

Assessing the Canada-U.S. Free Trade Agreement

Edited by
MURRAY G. SMITH
and
FRANK STONE

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Foreword

There remain many details of the proposed Canada-U.S. Free Trade Agreement unknown, and hence many potential consequences uncertain. But it is clear that implementation of the proposed agreement would remove many of the remaining barriers to commerce between Canada and the United States. It is widely accepted that the agreement offers aggregate economic benefits to both nations, while imposing adjustment costs on some groups. Beyond the economic implications, however, Canadians must be concerned about the potential implications for cultural, economic and political sovereignty. Some Canadians feel that further economic integration with the United States in the manner proposed by this agreement would unnecessarily limit Canadian policy autonomy and our discretion to pursue desirable national goals. Others believe that the provisions of, and the dispute settlement processes in, the proposed agreement, will limit potential encroachment upon Canadian policies from capricious unilateral U.S. trade actions.

The free trade negotiations between Canada and the United States, and the dramatic climax of those talks on October 4, 1987, have stirred intense public debate in Canada. The Institute has sought to contribute to a more informed appraisal of the possibilities for "free trade" through research conducted by the International Economics Program as part of its ongoing analysis of Canadian commercial policies and global economic relations. The Institute has also sponsored a number of conferences to provide a forum for commentary and debate about the implications of the negotiations and the proposed agreement. For example, early in 1987, the Insti-

tute co-sponsored with the Brookings Institution a conference in Washington examining the issues in the bilateral trade negotiations. Other such meetings are scheduled in both countries. This present volume contains the proceedings of a conference held in Toronto on October 28-29, 1987.

The Institute's objective in holding the conference was to provide a neutral forum to assess, on the basis of the materials available at the time, the implications for Canada of the proposed Canada-U.S. Free Trade Agreement. The first day of the conference was devoted to the exposition and analysis of the Elements of Agreement concluded between the two governments. The second day was devoted to a debate about the implications for Canada. The participants explored the regional, sectoral and labour market adjustment issues and some broader concerns with respect to cultural, economic and political sovereignty.

In publishing the proceedings of this conference, the Institute as a body seeks neither to support nor to oppose the proposed Canada-U.S. Free Trade Agreement. The Institute's objective is simply to contribute to more careful consideration of this important national question, in the light of broad social and political objectives, as well as careful economic analysis.

ROD DOBELL
President

Avant-propos

De nombreux détails de l'Accord commercial de libre-échange proposé entre le Canada et les États-Unis sont encore inconnus, d'où une incertitude quant à beaucoup de ses conséquences possibles. Mais il est clair que sa mise en vigueur supprimerait un grand nombre des obstacles qui freinent encore le commerce entre le Canada et les États-Unis. Il est généralement admis que, dans l'ensemble, l'Accord offre des avantages économiques aux deux pays, tout en imposant des rajustements de coûts à certains secteurs. Cependant, outre ses incidences économiques, les Canadiens doivent se préoccuper de ses conséquences éventuelles pour la souveraineté culturelle économique et politique de leur pays. Certains estiment qu'une plus grande intégration économique avec les États-Unis, selon les modalités proposées dans cet accord, restreindrait indûment l'autonomie du Canada en matière de politiques et notre capacité de nous fixer des objectifs nationaux souhaitables. Selon d'autres Canadiens, les dispositions de l'accord proposé, y compris ses mécanismes de règlement des différends, limiteront le risque que les États-Unis prennent, unilatéralement, et sans motif sérieux, des initiatives commerciales qui portent atteinte à nos politiques.

Les négociations canado-américaines sur le libre-échange, plus intenses que jamais auparavant le 4 octobre 1987, ont soulevé un débat passionné parmi les Canadiens. L'Institut a voulu participer à une évaluation plus poussée des possibilités de « libre-échange », grâce aux recherches faites par le Programme d'économie internationale, dans le cadre de son analyse constante des politiques commerciales du Canada et des relations économiques mondiales.

L'Institut a aussi organisé un certain nombre de conférences qui ont servi de tribune pour entendre des commentaires et des discussions sur les conséquences éventuelles des négociations et de l'accord proposé. Par exemple, au début de 1987, en collaboration avec le Brookings Institution, l'Institut a tenu une conférence à Washington afin d'examiner les différents aspects des négociations commerciales bilatérales. D'autres réunions semblables sont prévues dans les deux pays. Le présent volume fait état des délibérations d'une Conférence tenue à Toronto les 28 et 29 octobre 1987.

En organisant cette conférence, l'Institut a voulu qu'elle serve de tribune neutre où évaluer, compte tenu des éléments alors connus, les implications pour le Canada de l'accord de libre-échange proposé entre ce pays et les États-Unis. Les travaux du premier jour ont porté sur la présentation et l'analyse des Éléments de l'Accord conclu entre les deux gouvernements. Le deuxième jour a été consacré à une discussion de ses conséquences éventuelles pour le Canada. Les participants ont examiné les rajustements régionaux et sectoriels, ceux du marché du travail ainsi que certaines préoccupations plus évidentes touchant notre souveraineté culturelle, économique et politique.

En publiant les délibérations de cette conférence, en tant qu'organisme, l'Institut ne cherche ni à appuyer ni à rejeter l'Accord canado-américain proposé de libre-échange. Il veut simplement contribuer à un examen plus approfondi de cette importante question nationale, à la lumière des grands objectifs sociaux et politiques et grâce à une analyse économique des plus poussées.

Le président
ROD DOBELL

Biographical Sketches of Authors

Her Honour Rosalie Abella is Chairman of the Ontario Labour Relations Board and has been a judge in the Ontario Provincial Court since June 1976.

C. Michael Aho is Senior Fellow and Chief Economist at the Council on Foreign Relations in New York, and is Director of a multi-year project on the future of the world trading system and the challenges for U.S. trade policy.

Ivan Bernier is Director General of the Centre Québécois des relations internationales at Laval University. He was Director of Research (Law and Constitutional Issues) for the Royal Commission on the Economic Union and Development Prospects for Canada, from 1983 to 1985.

Gerald Caplan is a consultant and author of numerous books, articles and reviews in the area of Canadian history, politics, education and political socialization; African history and politics; and Third World politics, sociology, education, and health.

The Honourable Pat Carney is the Federal Minister for International Trade and Chairman of the Cabinet Sub-Committee on Trade. In this capacity she has responsibility for trade negotiations.

Roger Charbonneau is Chairman of the Board of Directors of the Institute for Research on Public Policy, the Banque Nationale de Paris (Canada), l'École des Hautes-Études Commerciales, Gaz Métropolitain, and Noverco.

The Honourable Grant Devine is the twelfth Premier of the Province of Saskatchewan, MLA for Estevan and has been Leader of the Progressive Conservative Party of Saskatchewan since November 1979. He became Premier and President of the Executive Council following the April 26, 1982, General Election.

Rod Dobell is President of the Institute for Research on Public Policy.

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Robert Jenness is Senior Policy Adviser, Economic Council of Canada.

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The Honourable Donald Macdonald is a partner in the Toronto law firm of McCarthy & McCarthy and co-chairman of the Canadian Alliance for Trade and Job Opportunities.

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The Honourable Jean-Luc Pepin is a Fellow-in-Residence at the Institute for Research on Public Policy, and is also Visiting Professor at the Faculty of Social Sciences, University of Ottawa.

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Paul Wonnacott is Professor of Economics at the University of Maryland, where he has been a member of the faculty since 1962. He was Visiting Fellow at the Institute for International Economics in Washington, D.C., in 1986.



Preface

The discussion and analysis in this volume is based on the Elements of Agreement reached in Washington on October 4, 1987. As we go to press, we have learned that the text of the agreement has been completed. Although the details are not yet available, we understand that the final text will not change substantially the discussion in the volume. Two changes are notable, however. The final text excludes transportation industries from the agreement in a manner analogous to the cultural industries, and there are no obligations with respect to Canada's postal rate subsidies.

Many worked hard to organize the conference in Toronto on October 28-29 and to bring the proceedings quickly to press. Lynda Lennon was at the centre of the action, ably directing traffic and orchestrating the efforts of all involved. She was aided and abetted by Marina Horrocks and Chandra Oodit, as well as Don Wilson who advised on conference arrangements. Many others from the Institute helped, most notably Rod Dobell, the President of the Institute. Lois Johnston supervised preparation of the manuscript and was ably assisted by Debrah Kearns, Jan Majocha and Melanie McDonald. The cover was designed by Jean-Luc Denat of Aartvark Communications. To all of these, to other Institute staff and members and to the speakers at the conference, who made time for this activity despite their own busy schedules, we owe a hearty thanks.

Murray G. Smith
Frank Stone
December 9, 1987

I
Introduction

Editor's Introduction

Murray G. Smith
Frank Stone

Most Canadians, and a number of Americans, will recall the shuttle diplomacy between Ottawa and Washington during the final ten days of the trade negotiations between Canada and the United States. During the annual meeting of the IMF and the World Bank, the U.S. Secretary of the Treasury, James Baker, put aside the task of resuscitating the fragile world financial system to meet, along with U.S. Trade Representative Clayton Yeutter, with Canada's Minister of Finance, Michael Wilson, and Minister of International Trade, Pat Carney. In these ministerial talks the trade negotiations finally received the high level of attention in Washington that Canada had been seeking during the previous 16 months of negotiations. At 11:54 p.m. on October 3, 1987, President Reagan transmitted a letter to Congress indicating his intention to enter into a trade agreement with Canada. It was not until Sunday October 4, 1987, however, that both sides initialled paragraph by paragraph a preliminary transcript of the *Elements of Agreement*.

The intense down-to-the-wire negotiations stirred mixed feelings among Canadians. On the one hand there was a sense that Canada had finally got the attention of a Reagan Administration that in principle supported free international trade, but which practiced a protectionist trade policy that was detrimental to Canada in industries such as steel and lumber. On the other hand many Canadians were uneasy about an agreement negotiated in apparent haste.

The uncertainty about the outcome of the trade talks during the final days before October 4 created a more mundane problem for us in the International Economics Program of the Institute. We began

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summer to plan an October conference in Toronto to assess the outcome of the trade talks. Needless to say, during those weeks when the talks hung in the balance, we had to put our plans on hold. When agreement was reached we had to work quickly to put the final touches on the organization of the conference.

The conference can be seen as a single frame in the long-running Free Trade movie. Although the "Free Trade" drama shifts back and forth between Ottawa and Washington, this particular movie has had more screen time in Canada than in the United States. The conference proceedings capture a particular moment in the Canadian debate about the Free Trade Agreement. In our view they provide analysis of the issues involved that could help inform Canadians. In addition the commentaries and discussion sessions evoke some of the colour and mood of the intense Canadian debate.

It is customary in an Editor's Introduction to summarize the contributions of all the participants. In this instance we let the authors speak for themselves, often with eloquence, passion or clarity. Rather we will review the *Elements of the Canada-U.S. Free Trade Agreement* and provide some historic context for the conference commentaries. We believe the review is objective. Others may disagree because Canadian perceptions of the negotiations and the Agreement are highly charged. You may wish to skip our prosaic review of the proposed agreement. We hope, however, that readers will focus to a greater extent on the specific issues raised by the Agreement in the context of the evolution of Canadian trade policy.

The Agreement in Canadian Trade Policy

The successful conclusion of the proposed Canada-United States Free Trade Agreement will be an event of historic importance for both countries. The agreement is multi-dimensional. It covers both tariff and non-tariff issues, as well as institutional arrangements. In many ways it extends and elaborates the forty-year-old commitments of the two countries on trade relations under the General Agreement on Tariffs and Trade (GATT) as well as prior bilateral agreements dating from the 1930s. The Canada-U.S. agreement will remove the remaining tariffs on cross-border trade, including most tariffs on agricultural products, although quotas and other restrictions will remain in a number of agricultural sectors.

The agreement parallels in some respects a number of other free trade areas created within the GATT framework, including the European Free Trade Association (EFTA), the bilateral free trade agree-

ments between the European Community and the EFTA countries, the U.S.-Israel Free Trade Agreement and the Australia-New Zealand free trade area. The agreement also attempts to resolve a variety of other economic and trade issues that are peculiar to the bilateral Canada-U.S. relationship, many of which are not new and have a long and tangled history. It is these latter elements of the agreement that are drawing the most controversy in the debate, at least on the Canadian side.

If the agreement is examined in the context of the GATT relationship and the formation and operation of other regional trade groups, and as an attempt to settle a variety of particular bilateral economic and trade issues, it is neither as awe-inspiring as some proponents claim, nor as cataclysmic as some opponents portray it: but it is nevertheless of major importance in the history of Canadian-American economic and trade relations.

The debate in Canada over free trade with the United States has a long and tortuous history, going back to the mid-nineteenth century at least, when the Reciprocity Treaty for a decade eliminated most customs duties on cross-border trade. During the first decade after Confederation, successive Canadian governments sought to renegotiate reciprocity with the United States but were rebuffed. When these efforts failed, Canada turned inwards with the National Policy of 1879, but with the hope expressed in parliamentary debates at that time that the United States would eventually see the error of its ways. Later in the nineteenth century and again in 1911 further attempts were made, unsuccessfully, to achieve free trade between the two countries. In 1911, however, it was Canada which rejected the treaty which had been ratified by the U.S. Senate.

After the havoc wrought by the great depression and the Smoot Hawley Tariff of 1930, Canada and the United States negotiated bilateral trade agreements in 1935 and 1938 which significantly lowered tariffs on cross-border trade. In 1948, another proposal to create a Canada-U.S. free trade area was considered, but Canada elected to pursue the slower process of liberalization of bilateral trade through the GATT.

Interest in bilateral free trade was revived in the 1970s, and gathered steam in the early 1980s for a number of reasons. One was the recession of 1981-82, which brought record-high interest rates, a sharp increase of unemployment, and further declines in commodity prices. The recession was viewed in Canada as the product of external forces and events over which Canadians had little control or influence; and it reinforced the view of many Canadians that a solid foundation for Canada's economic future required more open and

assured access to the large U.S. market.

A second reason was the emergence of stronger pressures for protectionist trade policies in the United States during the recession, which intensified during the subsequent recovery by the strong U.S. dollar. These pressures resulted in a wave of measures under U.S. "trade remedy" laws that limited important Canadian exports, including softwood lumber, Atlantic groundfish, pork and hogs, shakes and shingles, and steel. These U.S. measures demonstrated the need for new bilateral rules and mechanisms that would limit the scope for unilateral decisions to restrict competitive Canadian exports to the United States.

A third factor that stimulated interest in new bilateral trade arrangements was a perceived decline in the effectiveness of GATT as an instrument for regulating world trade, as well as for protecting and advancing Canada's trade interests, especially since GATT represented Canada's main trade agreement with the United States. For both countries, the 1982 GATT Ministerial Meeting was a disappointment because of its failure to launch new initiatives to strengthen the GATT rules and to promote further global trade liberalization. Moreover many of the U.S. trade actions against Canadian exports were technically consistent with GATT.

Finally, profound changes had taken place in the pattern of world production and trade. Canadian producers faced new and strong international competition, especially in the manufacturing sector, from newly industrialized countries in the Pacific rim area. The pace of technological change had also quickened. These developments reinforced a widely held view that Canada's confined domestic market severely limited the scope for achieving a more competitive Canadian economy.

All these factors appear to have had a bearing on the initiative taken by the Liberal government in late 1983 and early 1984 to launch discussions with the United States on possibilities for removing bilateral trade barriers in a number of specific product areas including steel, farm equipment, urban mass transit equipment, and computer services. This sectoral approach, however, soon ran into serious problems. It tended to draw out the opposition to trade liberalization in the particular sector concerned without drawing out the supporters. It proved difficult to reach a reasonable balance of advantage for the two countries in isolated, relatively narrow sectors. And it became evident that the two countries would need to obtain a series of special waivers from the GATT Contracting Parties for new preferential bilateral arrangements that would fall far short of the kind of comprehensive free trade arrangement that is permitted by the GATT rules in Article XXIV.

Prime Minister Mulroney's government, after taking office in September 1984, enlarged the initiative to embrace a broader effort to remove barriers to cross-border trade on a comprehensive basis, to improve the rules governing this trade, and to develop dispute settlement mechanisms to deal with a number of longstanding frictions in the economic and trade relationship; in other words to create a bilateral free trade area of the kind authorized by the GATT rules. Both the Liberal government's earlier initiative and the Mulroney initiative received a positive response in Washington, where frustrations existed about the trade policies of other major trading partners of the United States, and where apprehensions about the future of GATT had emerged. Moreover the Trade and Tariff Act of 1984 specifically provided the Administration with authority to negotiate bilateral trade arrangements with Canada, subject to Congressional review. An interim discussion on the scope for negotiations was launched in March 1985 at the Quebec City meeting of Prime Minister Mulroney and President Reagan. In September 1985 Prime Minister Mulroney proposed that formal negotiations should be opened. In Washington a signal about obstacles to the success of the negotiations came when the Senate Finance Committee in April 1986 came close to adopting a resolution to disapprove the talks. Despite the turbulence that characterized the talks, their outcome follows a general trend in Canadian trade policy pursued actively since 1983. Indeed the initiative for a comprehensive free trade agreement is well rooted in a much longer sweep of Canada-U.S. trade and economic relations.

Summary of the Agreement

Tariffs

The schedules for tariff removal are not yet available, but it is intended that some will be removed on January 1, 1989; others in equal stages over a five year period beginning January 1, 1989; and the remainder in equal stages over a ten year period beginning January 1, 1989. Duty drawbacks on goods imported from third countries will be eliminated for bilateral trade after 1994; duty waivers tied to specific export performance will be prohibited, and existing duty waivers eliminated by 1998. The U.S. customs user fees will be phased out on bilateral trade by 1993.

Rules of Origin

To qualify for tariff-free treatment, goods must originate in Canada and in the United States; if they incorporate offshore raw materials or

components, goods must be sufficiently changed to be classified under a different tariff heading, although in cases involving assembly of components, the product will need to embody a specified percentage of manufacturing cost in one country or the other.

Quantitative Restrictions

The GATT rules, which generally prohibit quantitative restrictions on exports and imports with specified exceptions, will apply. Existing restrictions not consistent with GATT rules will be eliminated or phased out, or will be "grandfathered in specific cases". For example, Canada's export controls on logs and the Memorandum of Understanding on Softwood Lumber are grandfathered.

Agriculture

Nothing in the Agreement will prevent Canada from maintaining import quotas consistent with GATT rules in support of supply management programs. All tariffs on agricultural products will be removed by the end of ten years, but for a twenty-year period Canada may impose temporarily the existing "seasonal duties" on fresh fruits and vegetables, which are now regularly applied during the growing season. Restrictions under the meat import laws of the two countries, which have been used periodically and only for beef, will not in future be imposed on bilateral trade. Canada will be exempt from any future U.S. import restrictions on products containing less than 10 per cent sugar and on grains and grain products. Existing Canadian quotas on imports of eggs, chickens and turkeys will be slightly increased to correspond to levels of actual imports over recent years. No changes will be made in the restrictive import systems of the two countries covering all dairy products. Canada will eliminate existing import licences for wheat, oats and barley and their products when subsidy support levels for these products become equivalent on the two sides. (For barley and oats this may be by January 1989.) Canada retains, however, the right to control imports through "end-use" certificates in order to protect the Canadian grain quality control system.

Agricultural subsidies are highly contentious in world trade. Both sides have agreed they will not subsidize agricultural exports to the other. For example, Canada will remove subsidies under the Western Grain Transportation Act on exports to U.S. markets. The agreement also contains undertakings to consult in order to limit damage from export subsidies to each other's exports of agricultural products

to third countries. It was not possible for Canada and the United States to go further in limiting agricultural subsidies because it is the subsidy practices of the European Community that are most disruptive to global agricultural trade.

New arrangements for bilateral consultations on agricultural trade issues are created and the two countries will join in efforts within GATT to improve conditions for world trade in agricultural products during the Uruguay Round.

Automotive Trade

The Automotive Agreement remains in place, but duty-free imports of parts, components and vehicles from third countries will be limited to existing producing firms (mainly General Motors, Ford and Chrysler), as long as they continue to meet the Canadian content requirements in "the Autopact safeguards." This means that Japanese, Korean and other third country producers will not be entitled to duty remission on their imports of vehicles, parts and components. Tariffs in the automotive sector, as in other sectors, will be removed over a 5-10 year phase out period. The Elements document proposes new rules of origin: 50 per cent on the direct cost of manufacturing in Canada or the United States. There are pressures on both sides of the border to increase even further this content requirement which will presumably result in greater use of North American parts and components, but which could lead to frictions with major trading partners. Canada's long existing embargo on imports of used cars will be lifted in stages. A blue-ribbon panel will be created to advise the two governments on the auto industry.

Alcoholic Beverages

Discriminatory provincial markups for spirits are to be eliminated immediately and those for wine over a seven year period, but beer is not included in these arrangements. The agreement reduces other forms of discrimination against U.S. spirits and wines, and provides national treatment under future changes in distribution systems. Tariffs will be phased out for alcoholic beverages, as for other goods.

Energy

All tariffs, non-tariff measures and trade restrictive practices will be eliminated, with some exceptions, on oil, natural gas, coal, electricity and uranium. The agreement will preclude U.S. restrictions on

imports of Canadian uranium, and will also relax the U.S. embargo on exports of Alaskan crude oil to Canada, up to 50,000 barrels a day. Both sides have agreed not to impose import or export duties or taxes. Quantitative restrictions on energy imports or exports that are not explicitly grandfathered or that are consistent with GATT Article XX, (e.g. conservation of an exhaustible resource) are precluded. In event of rationing of energy supplies there is a prorationing formula to be applied, but the International Energy Agreement takes precedence. Regulatory measures affecting cross-border trade in energy products will also be eased.

Government Procurement

Both sides will extend the provisions of the existing GATT code, in order to expand access by their firms to non-military purchases by the federal government in the other country. The threshold on bidding for government purchases will be on a bilateral basis, lowered from U.S. \$171,000 to \$25,000.

Technical Standards

Commitments on the two sides under the GATT code will be extended. Federal standards will be further harmonized, and procedures for establishing standards and for the mutual recognition of product certification will be streamlined. A process will be initiated to resolve long standing differences over plywood standards.

Services

The agreement establishes a set of principles to discipline future policies and practices on both sides governing trade in services. These principles include rights to national treatment, commercial presence and establishment, and cross-border sales. Additional sectoral annexes will be prepared to clarify these principles with respect to transportation, telecommunications and computer services, tourism and architecture. (Basic telecommunications services, such as long-distance telephone services, are not covered.) The agreement also contains provisions that will allow easier border crossing by business travellers.

Existing rules governing financial services will be maintained, and conditions of access and competition in financial services are to be improved. Canadian banks in the United States will be able to underwrite Canadian government securities. Canadian financial institu-

tions will be treated the same as their U.S. counterparts under any changes in the Glass-Steagall Act (which governs the relationship in the United States between banks and the securities industries). Restrictions on the assets of U.S. banking subsidiaries in Canada are lifted, as are restrictions on U.S. portfolio ownership of Canadian banks.

Investment

No general controls on cross-border investment will be permitted, except on the Canadian side. Investment restrictions remain, however, for certain designated industries in each country. Canada undertakes a commitment to continue existing policies of not screening new business investment; to phase in higher levels for the screening of direct takeovers (to \$150 million from \$5 million); and to phase out the review of indirect takeovers. Canada will also phase out requirements for minimum equity holdings by Canadians in U.S.-owned firms as well as performance requirements applicable to foreign-owned firms that affect trade with the United States.

Intellectual Property

The two sides agreed to resolve a long-standing dispute over cable retransmission of broadcasting. Canada has indicated previously that it will proceed with a compromise solution on licencing of pharmaceuticals. Since the two countries were unable to agree to eliminate performance requirements and compulsory licencing of pharmaceuticals, Canada will not be exempt from U.S. trade legislation that allows trade penalties against foreign practices which damage U.S. intellectual property rights.

Cultural Industries

Government support in Canada for cultural industries (films and video, music and sound recording, publishing, cable services and broadcasting) are not affected by the agreement. However, the Canadian government will phase out some discriminatory practices, including differential postal rates for U.S. periodicals of significant distribution. Existing Canadian rules which deny tax deductions for advertising on U.S. border broadcasting systems will remain intact, as will special provisions restricting and regulating investment in cultural industries in Canada. Since cultural industries are excluded from the agreement, new measures favouring Canadian cultural

industries can be introduced, and the United States retains the right to introduce equivalent policies.

Subsidies, Countervailing Duties and Dumping

No changes will be made in existing laws and practices governing the use of countervailing duties and anti-dumping duties. However, decisions on such measures in either country may be appealed to an independent, bi-national dispute settlement panel established on an ad hoc basis to review particular cases. Such reviews, however, will be limited to determining whether existing domestic laws and practices have been followed correctly. Decisions of the panels will be binding.

Concurrently, the two parties will work towards establishing a new regime to govern the use of countervailing and anti-dumping duties on cross-border trade. These new arrangements would be designed to come into effect after a five-year period, which might be extended to seven years.

In addition, any changes in existing countervailing or anti-dumping rules would apply to the other country only after consultation and if specifically called for by new legislation; either side could ask for a review of such changes by an independent panel; and failure to abide by the recommendations of the panel could lead to compensatory measures or the termination of the whole agreement.

Emergency (Safeguard) Import Measures

Safeguard measures imposed on a global basis would apply to the other party only if that country were an important cause of serious injury; and any such restrictive measures would be subject to compensation and could not reduce levels of imports below levels over a recent previous period. A bilateral safeguards track is created that permits, during the transition period, the suspension of tariff reductions. Any increases of tariffs would be capped at pre-agreement MFN levels, and would be limited to three years.

Institutional Elements and Dispute Settlement

The special arrangements for bi-national dispute settlement in anti-dumping and countervailing duty cases are described above. The agreement also provides for several other institutional arrangements and procedures for the resolution of disputes.

The agreement will establish a "Canada-United States Trade Commission" composed of senior representatives of the two governments,

including (but not limited to) the Canadian Minister for International Trade and the U.S. Trade Representative. This Commission will have broad functions: to supervise the implementation of the agreement, to resolve disputes arising from its interpretation or application, to oversee its further elaboration, and to consider other matters affecting its operation. The Commission is to meet at least once a year, with each party presiding in alternate years; and it may establish subsidiary standing committees or working groups. Decisions of the Commission are to be taken by consensus.

At the request of either party the Commission may make recommendations on disputes arising from the interpretation and application of the Agreement. By mutual agreement the Commission may refer such disputes to binding arbitration. Other disputes also may be referred for binding arbitration, as agreed by the Commission; or the Commission may seek the advice and recommendations of panels, on the basis of which it would then reach decisions.

Panels would be selected by the Commission as the need for them arises. They would be composed of five members, two from each country, and a fifth member from any other country. Each party would choose its two members, while the Commission would choose the fifth. Failing agreement, the other four members would make the choice or the fifth could be selected by lot. Where the arbitration process finds one side in breach of the Agreement, the other country would be entitled to suspend the application of equivalent benefits.

The normal dispute resolution procedures under GATT would also continue to be available to deal with issues covered by GATT rules. Appeals would have to be made either under the GATT procedures or under the agreement, but not both.

The GATT Context

Within the GATT framework, a variety of free trade areas and other regional trade groups have been formed during the postwar period, in Europe, the Caribbean region, Latin America and elsewhere. As noted above, the GATT rules in Article XXIV permit the formation of such groups, as a matter of right, under specified conditions; and all of them involving GATT members have been subjected to close examination in the GATT. With a few exceptions, the GATT Contracting Parties have neither formally approved nor condemned these arrangements, although many have been criticized for one reason or another as failing to conform to the GATT rules. Both Canada and the United States have generally encouraged the forma-

tion of such groups, or at least have not actively opposed them, on grounds that trade liberalization on a regional basis contributes to the economic growth of the members with benefits to outside countries as well, or that these groups serve broad political and security objectives. A result of the formation of regional trade groups is that Canada is one of the few industrialized countries without open access to large markets. Indeed only Canada and Japan among OECD countries do not belong to regional trading arrangements.

On the basis of available information, it seems clear that the Canada-U.S. Free Trade Agreement will be compatible with the GATT rules governing free trade areas and, indeed, will probably conform more closely to these rules than most other such arrangements that operate within the GATT framework. The most contentious issue in the GATT review of the proposed agreement could be the new rules of origin for automotive trade, particularly if these are made more restrictive.

It is noteworthy that the bilateral Agreement contains many cross-references to the commitments of the two countries under GATT. Indeed in many practical ways as well as in legal terms the GATT will continue to remain the basic trade agreement between Canada and the United States, as well as the main trade agreement of each with other countries. There is nothing in the bilateral Agreement that stands in the way of continued and strong efforts by both Canada and the United States to improve and enlarge the multilateral system centred on GATT, or in the way of the active participation of the two countries in the newly opened Uruguay Round of global negotiations within GATT. In some respects, the bilateral Agreement can set an example and open new directions for multilateral trade liberalization and for an improvement of the GATT rules for world trade.

Despite the conformity of the Canada-U.S. Free Trade Agreement with GATT rules, legitimate concerns can exist in the two countries and in other countries as well that the agreement could, in fact, result in weakening the GATT system and cause damage to third-country relationships. To allay such apprehensions, the two governments might clarify, jointly or separately, the following points at some early stage: that each stands ready to consult with third countries in GATT on trade problems which may be created by the agreement; each country seeks to strengthen the GATT rules, to reform the GATT dispute settlement process and to play an active leadership role in the Uruguay Round of GATT negotiations; and that during the Uruguay Round of negotiations both countries, on the basis of balanced reciprocity, would be prepared to exchange with other GATT members on a most-favoured-nation basis at least some of the benefits

exchanged bilaterally under the proposed agreement. If Canada and the United States pursue this approach, the Canada-U.S. agreement could help stimulate progress in the Uruguay Round and serve to strengthen the GATT system.

Canadian Concerns

Canadian concerns about the agreement involve questions about the implications for adjustment in the Canadian economy and the consequences for Canada's cultural, economic and political sovereignty.

Adjustment

The prospect of removing all remaining tariffs on cross-border trade understandably has created apprehensions about the loss of tariff protection in particular sectors, which could lead to job losses, plant closures and other dislocations. The process will be gradual, spread over as long as ten years in many sectors. The process will complete the reductions achieved in successive rounds of GATT negotiations over the postwar period. These have reduced tariffs on the Canadian side from an average of around 21 per cent on dutiable goods in 1947 to the present 8-9 per cent range. On the American side, tariffs have been cut from an average of around 32 per cent to the 5-6 per cent range. Although some tariffs still remain high on both sides — especially on consumer goods and in the petrochemical sector — the magnitude of the adjustment required appears to be comparable to that experienced during the implementation of the Tokyo Round of GATT.

Sovereignty

The most highly charged issue in Canada-U.S. relations involves the question of actual or perceived infringement by the United States on Canada's sovereignty. Sovereignty is a highly subjective concept involving economic, political and cultural dimensions. The issue has become more contentious in recent years because U.S. protectionist pressures have been channelled into complaints about the alleged unfair practices of its trading partners. The U.S. assault on real or imagined unfair foreign practices raises particular problems in Canada because of the extent of Canada's trade dependence on the U.S. market. In the softwood lumber case, for example, U.S. interests argued that differences in U.S. and Canadian stumpage practices gave an unfair advantage to Canadian producers.

As John Jackson, a U.S. expert on international trade law, observes:

What is often surprising, however, is that even nations with very similar economic systems, such as two industrial country market economies, can find that minor variations in their economic systems can create situations which have the appearance of unfairness. Those situations may have arisen almost completely by accident. That is, there may have been no intention to engage in any practice which is deemed 'unfair'.⁽¹⁾

Jackson then suggests a different term to describe the economic frictions that arise between countries:

I have termed this problem the "interface" problem. ... When it is desired that two computers of different makes work together, it often takes some kind of "interface" mechanism or program to mediate between them and to translate the language of one machine to that of the other. Likewise, when two societies with even minor economic differences desire to work together, frictions or misunderstandings can occur unless there is an interface mechanism. To a certain extent, the national trade laws and the GATT Bretton Woods System are operating today as a rather crude interface mechanism. The problem often is that policy leaders have not perceived this, but instead believe that it is necessary to characterise some practices as "unfair" or "illegal". In at least some of the international trade problems which exist today, a more neutral terminology and policy approach that would avoid moral overtones may operate with greater utility for world economic welfare and harmony.²

A key issue for Canadians will be whether the proposed agreement, and the dispute settlement mechanisms contained in it, provide a better "interface" mechanism for managing economic relations with the United States without imposing undesirable constraints upon Canadian policy choices.

Conclusions

In many ways the Canada-U.S. Agreement goes well beyond the kind of free trade arrangements envisaged by the architects of the GATT rules, but it conforms to these rules. The form and provisions of the bilateral agreement necessarily reflect the special and unique conditions surrounding the Canada-U.S. trade and economic relationship: the massive volume of cross-border trade in a full range of goods and services; the close and intricate pattern of the bilateral

relationship; and the inevitable frictions and strains in the relationship which have become intensified recently, although some disputes have long roots.

The agreement is of historic importance in removing remaining tariff and many other barriers to bilateral trade. Key elements of the bilateral agreement can be seen, in part, as efforts to resolve or at least contain a number of strictly bilateral issues which include, among others, two-way flows of private investment, the special problems of trade in energy products, production and trade in automotive products, and the procurement of goods and services by governments. It is perhaps to be expected that these particular elements of the Agreement, as distinct from the removal of tariff barriers, are most controversial in the debate on the free trade agreement on both sides of the border.

The institutional elements of the bilateral agreement reflect the particular circumstances of the Canada-U.S. relationship. The Agreement stops short of creating a strong bi-national body to supervise it and leaves largely intact the domestic trade laws and practices that have so frequently been used in ways which create uncertainty and cause bilateral frictions. But the provisions for the appeal of disputes of various kinds to independent bi-national panels are, in our view, an improvement over existing arrangements; these provisions could restrain abuse of the trade laws and could be a step towards more formal and effective institutional structures. These provisions might be regarded as embryonic and are likely to evolve over time, as the Agreement comes into full implementation.

Notes

1. J.H. Jackson, "Achieving a Balance in International Trade," *International Business Lawyer* (April 1986), p. 124.
2. *Ibid.*

Opening Remarks by the Chairman of the Institute

Roger Charbonneau

Mesdames et messieurs, bonjour. It is my pleasure on behalf of the Institute for Research on Public Policy to welcome you to this meeting to examine the proposed Canada-United States bilateral trade agreement. I say "to examine" advisedly. Our purpose in organizing this meeting is not to promote support for what has been negotiated, but to encourage close public scrutiny of the proposed arrangements and to open debate as to their merits and consequences. Seldom in Canada has a question raised so much interest and been so widely debated, which is understandable as very few matters present such varied economic, social and political aspects both for the short and the long term.

Today our hope is to move the debate as much as possible away from hypothesis and toward the more concrete aspects of the question. For this purpose the program devotes the first day, starting with keynote addresses by the Honourable Donald Macdonald and Ambassador Reisman, to an explanation and interpretation of the text of the proposed agreement and the process of its implementation.

Tomorrow we will open up the discussion and debate the significance and merits of the deal. We are fortunate to have the benefit of some very authoritative opinions on these questions, and to have with us some influential political leaders. We are particularly happy that the Honourable Pat Carney and Premier Grant Devine have agreed to address us. Ms Carney is our dinner speaker this evening. Premier Devine will be our lead-off speaker tomorrow morning. We had hoped also to be able to hear some further perspectives on the debate from Premiers Peterson, Pawley or Ghiz, but this has not proved possible.

We do, however, have some very able people from a variety of positions on our panels tomorrow. I hope that you find the program informative and illuminating. Speaking personally, I am happy to see this kind of demonstration that the Institute's research program can be relevant and timely in dealing with issues of vital concern to business and industry in this country. It gives me great pleasure to welcome you here today, and now to turn things over to Jean-Luc Pepin, our chairman for this morning. Thank you.

Jean-Luc Pepin:

Merci, Monsieur Charbonneau. As Mr. Charbonneau has told you, ladies and gentlemen, we have two wonderful speakers for the morning part of the seminar, Mr. Macdonald and Mr. Reisman.

Introducing Donald is easy. He will describe to you the road to Damascus. Ladies and gentlemen, I have often, like you, listened to people introduce speakers with extraordinary words when the speaker needs no introduction, and then usually find a way to put in 15 minutes of statistics and flattery of the speaker. I have always wondered if somebody, some day, would have the courage to say the speaker needs no introduction and to live up to that. I will. Ladies and gentlemen, Mr. Macdonald.

II *Overview of the Agreement*



Overview of the Agreement

Donald Macdonald

I'd have to say my first sentiment in getting up here is one of intense relief, given that the principal negotiator on the Canadian side is not present. So I can make comments about his Oh, there he is. I am now less relieved and I will be more careful.

The task that I've been set, along with Simon Reisman, is to give an overview of the agreement. There are some aspects of it on which I don't claim any competence. I decided not to talk about the automobile industry. Looking at the audience I'm reinforced in that, not only by the presence of Simon, but also of Paul Wonnacott.

I was also not going to say anything about the grain trade, and my decision is reinforced by seeing Esmond Jarvis. So there will be a number of the functional parts of the arrangement that I'll not refer to. However, having been one of those responsible for the energy crisis of 1973-74, I do feel fully confident to comment on those aspects of the deal and intend to do so.

But let me start off by talking in the broadest terms about what has been wrought in this agreement. I just say to Mr. Charbonneau that it is true that we are closer to the substance of the agreement that is going to be made, but we're not there yet. All of us are still proceeding on the basis of the "Preliminary Transcript". A document of that relative brevity necessarily has to abbreviate some important questions that we can't be certain about. So this morning we're talking about what appears to us now. When the definitive agreement is available, we will be able to talk with more authority.

Let me start with a general view of the agreement; first, what I regard as one of the major achievements. There has been agreement between Canada and the United States to eliminate virtually all the industrial tariffs outstanding between the two countries. This will be

done in three phases over 10 years. The first will be effective on the operative date of the agreement, the second comes into effect by equal reductions over a five-year period. And the remaining group of tariffs will be reduced over a 10-year period.

I think I'm right in saying that most of the agricultural tariffs are to be phased out as well. Many of the most sensitive commodities in Canada are covered by supply control marketing boards, such as those for milk and poultry. These particular sectors of our economy remain untouched by the agreement. Nevertheless, there will be a general reduction in tariffs and this will happen over a period that will provide Canadian industries, particularly those that are sensitive to the changes, time to adjust and time to meet the new competitive opportunities that will arise.

The more difficult area in the agreement, and I'm sure in the negotiations, was that of non-tariff barriers. The great disappointment, I'm sure, from the Government of Canada's standpoint, and certainly for me, was the very limited progress made in the area of government procurement. Basically what has been done is to lower the threshold, as agreed to under the Tokyo Round agreement on procurement of 1979. The bilateral agreement will bring it down to a level of \$25,000, and a figure of about \$4 billion has been put out as the potential gain per annum, coming from that particular lowering of the threshold. But as I understand it, some of the important sectoral exclusions that were left untouched by the Tokyo Round agreement still remain untouched by Canada and the United States. I have in mind here a number of industrial areas that are of considerable importance to Canadian industry — telecommunications and telecommunications equipment for example. And with regard to surface transportation equipment, the U.S. federal and state "Buy-America" restrictions remain untouched, and so the agreement is disappointing from that standpoint.

Perhaps an even greater disappointment is the fact that, although best efforts are being made to do something about the subdivisions of government, the states in the United States and the provinces in Canada, there has been no substantial undertaking on the part of the regional levels of government to remove the considerable discriminatory practices they follow in relation to government procurement.

In the case of state governments, there are some Canadian industries that would have benefited considerably from the elimination of the procurement restrictions at the state level; that is not to be attained. Equally, there are American firms that would have stood to gain from the elimination of provincial barriers, which are extensive in Canada.

There is another aspect, of course, where the failure to breach the provincial barriers has to be a disappointment to Canadians. One of my objectives would be to have not only freer trade with the United States, but to have freer trade with Alberta or other provinces within Canada. And despite all the rhetoric at the provincial level, there still remains a substantial apparatus of barriers to trade from province to province. Conceivably a free trade area agreement that would have dealt with the provincial limitations in benefit to American suppliers would also have lifted the same barriers with respect to other Canadians. In that sense, the failure to achieve something at the international level has meant that the provincial governments have no particular incentive to try to overcome the protectionism in which they engage on behalf of their local communities.

On the question of safeguards, the provisions governing the kind of remedy that was invoked against us in the shakes and shingles case are probably as reasonable as could be attained, recognizing that safeguards are permitted under the General Agreement on Tariffs and Trade. The safeguards in this Free Trade Agreement are to be limited in application to one three-year period only. What's more — and I think this is probably a distinct gain from our standpoint — under the general dispute settlement provisions of the agreement, the Canada-U.S. Trade Commission is obliged to refer all disputes with regard to safeguards to binding arbitration. So, in that sense, in looking back to the shakes and shingles case, there would have been an opportunity to have that decision scrutinized within the Canada-U.S. Trade Commission, and then to test both the facts and the application of the law before a bi-national panel — to have it tested by something more objective than a presidential decision.

The area of non-tariff barriers that has drawn the most attention in Canada and, I think, the most criticism, concerns anti-dumping and countervailing duties. This has been a major Canadian concern and it remains a concern today. An example of anti-dumping duties was potash and, of course, softwood lumber represents the countervailing dispute. What has really happened is that what we on the Royal Commission hoped might be achieved has not been — the negotiation of an agreement between Canada and the United States on a code of economic conduct with respect to the use of subsidies, and therefore, a code of economic conduct with respect to the use of countervailing duties.

The negotiators, having acknowledged that they could not arrive at an agreement, have at least created another process, a process over five years to attempt to arrive at an agreement on subsidies and countervailing duties. There is the possibility of extending those

negotiations for a two-year period. It is something, but it is disappointing that there is not going to be a code available. The measures that are going to be put in place on both sides of the border will still continue. But instead of the ultimate judgment on questions of law being made by domestic courts — the Federal Court in Canada or the American Court of International Trade — we are going to see a situation where a panel will review the domestic decision. The panel will review the processes followed by the administrative tribunals on either side of the border to make certain that, at the very least, the judgment was made in accordance with the law of the country in question.

Having talked to some of the counsel involved in the softwood lumber case, the consensus is that the panel provision would have produced a different decision in the softwood lumber case. What has been done is to negotiate some means of checking the objectivity of the tribunal. But the criteria the tribunal is to apply and the ability to have a further exploration of fact have not yet been attained. I would imagine that they would be the subject of negotiations in the period to come.

One of the critical questions, of course, is what happens during the interval after these negotiations? What if either Canada or the United States changes its domestic law, so as to make it more certain that the applicant within its jurisdiction will be able to get a successful result? Well, that has been anticipated in the negotiations. Changes in the law must first be specifically directed at the other country. In due course, there has to be notification and consultation on the changes, on whether they violate the agreement or the provisions of GATT. They may be scrutinized by a panel. And if the country, by changing the law, is found to be in violation of its obligations but insists on going ahead, then the other party is given the opportunity of retributive action; that is, withdrawing benefits of an equivalent nature from the other side. So there are some sanctions that will be available during the time that a further agreement on subsidies and countervailing duties is under negotiation.

Let me highlight a particular disappointment. The signals coming from the negotiations indicated at one time that anti-dumping duties might have been abolished altogether between the two countries, on the assumption that having achieved essentially an open market, there is no utility in having anti-dumping duties. That, of course, was not attained, and one would hope that perhaps the issue would also be a subject of continuing negotiation.

Let me say a word about the dispute settlement provisions that have been arrived at. I have to acknowledge at once that they are not

as comprehensive as those that our Royal Commission proposed, although many of the elements of the Commission's proposal do find themselves in what has been decided.

I have already talked about the special case of dispute settlement in regard to anti-dumping and countervailing duties. An objective panel is to be made up of two appointees from each country with the fifth person to be chosen either by those appointees or to be chosen by lot, thereby providing a panel of, one hopes, some objectivity where the measures taken within domestic jurisdiction can be determined. I'll say nothing further about that.

I think what probably is of greater long-range significance is what I would call the "general procedure", the dispute resolution procedure available for the rest of the agreement, for scrutinizing the disputes that will arise between Canada and the United States and that fall within the framework of the general agreement. Of course, the parties are still left, in appropriate cases, with their resort to the GATT dispute settlement procedures, ponderous though they may be. It may well be, in some circumstances, that a party will choose to put an issue to GATT rather than to this tribunal. One would think, however, that the better wisdom would be to take advantage of the specific bilateral tribunal created by the agreement — the Canada-U.S. Trade Commission.

The Commission, of course, is a political body, to be chaired by very senior representatives from each side of the border. It is to have on it other informed and authoritative members and a staff to assist in its continuing work. Its primary function, apart from keeping the general operation of the agreement under surveillance, will be, in terms of disputes, to try to provide a forum for consultation and a medium through which settlement can be negotiated between the two parties.

In this agreement, there is also the obligation on both parties to notify changes in law or policy that may have an adverse effect on the other party in relation to the agreement. And they are obliged, on request, to consult on such measures.

As well, there is a defined timetable set out for each stage of the dispute settlement procedure. It includes the successive steps requiring various processes to be completed in a certain time, and it requires reporting back. Rather than being able to take advantage of the lawyers' and the legislators' principal weapon — the law of delay — there is a specific timetable that has to be adhered to. There is a timetable for consultation, for establishing bi-national panels, for the initial report of the panel. There is a time for the response to the panel's deliberation, and a time for the final report. At the end of it

all, the aggrieved party, if it finds that the Commission has failed to resolve the outstanding dispute, is then given the freedom to suspend, to borrow the words of the preliminary transcript, "benefits of equivalent effect". In effect, it is given a form of sanction, similar to that under Article XXIII of GATT, that can be applied against the other party.

Let me comment on the procedure. I think that over the long run it will be seen as a considerable advantage from the standpoint of Canada-U.S. relations. There has been a wide range of trade disputes between the two countries that have not been inserted within a more precise structure of an institution. Under these procedures there are the obligations to notify and consult, and there is a forum provided to try to resolve the dispute by non-litigious means; that is to say, by negotiation. But in the event of failure, there is a requirement to submit the dispute in question to an objective tribunal. This tribunal which, unlike the one in the case of anti-dumping and countervailing duties, will be able to look at the broader measures of the agreement itself, will be able to scrutinize the particular instance from the standpoint of fact; it will therefore be able to make a much broader decision regarding the appropriateness of the measure that the particular country has taken, and regarding the appropriateness of the complaint. There is, above all, the ability to resort to retaliatory measures if that happens to be appropriate.

This entire procedure has a number of advantages. It is less ponderous, as I have said, than the GATT panels have been. In the GATT panel — this may be contentious, but certainly in the view of some people — there's always the risk of national interest on the part of some participants in the panel rising above the need for objectivity. The concern in that regard will be specifically addressed in the agreement by having two sides represented by two participants, by choosing the chairman. There is specialized attention to problems within the Canada-U.S. context. I think, just as with the International Joint Commission, it would be much more difficult, much more ponderous, to have those kinds of questions discussed and, indeed, litigated before the nationals of other countries. These will be considered within the common ground of the Canada-U.S. context, and I regard that as an advantage.

Above all, there should develop a body of jurisprudence — if I can use that phrase for something which is not entirely a legal process — a body of guidance to governments, and for the nationals of the two countries that are interested in the outcome of the agreement, to govern future action and the way in which the agreement should apply. Above all, there is an advantage in a single tribunal of this kind

making certain that although each panel is going to be a different one, there will at least be some conformity between the decisions as they are made from time to time.

Let me switch to the question of energy, and then I'll conclude. This is an area where we're particularly subject to what the actual draft says in the page-and-a-bit related to energy. There are some quite general terms in the text and, in this rather complex sector, one can't be confident exactly how they will be worked out in practice. But in the very broadest terms, it achieves a balance between the two principal problems that have been outstanding between Canada and the United States since Canada emerged as a major energy supplier in the late '40s. One problem has been that in times of plentiful supply of energy commodities in both the United States and Canada, either on a world basis or on the continental basis, private interests in the United States have been energetic to keep Canadian supplies out. There have been a very limited number of occasions when energy has been in short supply, as was the case in 1973-74. The grievance then was on the other side, an American grievance, that having established a market and a dependence on Canadian energy supplies, Canadians threatened and, in a number of cases, actually did withdraw supply to the potential prejudice of Americans who had come to rely upon it.

The energy agreement, it seems to me, has arrived at a balance between these two concerns. First, with regard to surplus, there have been efforts over the years on the part of American private interests to exclude Canadian energy supplies from the U.S. market. For example, in the late '60s and early '70s, we had the embargo on Canadian uranium going into the U.S. market for power purposes. In the early '70s we had the partial Nixon embargo on oil. And over the years we have had regulatory action taken by the American energy tribunal that very much conditioned the circumstances under which Canadian natural gas could be sold into the U.S. market. In the 1980s, we are back to that same problem again. The same law that was invoked against us in the late '60s and early '70s with regard to uranium is now before the courts in the United States. And unless there is alternative decision, you can expect to see an embargo again. Some of the American private interests, the coal interest for instance, are now threatening countervailing duty action against the electricity sales by Manitoba and Quebec Hydro into the U.S. market, and the Federal Energy Regulatory Commission (FERC) by rulings it has made, has been limiting access of Canadian natural gas to the U.S. market at this time of surplus.

I put these as questions. First, at the top of page 17 of the preliminary transcript, the text says:

Both sides have agreed to prohibit restrictions on imports or exports including quantitative restrictions, taxes, minimum import or export price requirements, or any other equivalent measure, subject to very limited exceptions.

Hereafter, then, will the National Energy Board be able to follow the criterion of imposing a surplus requirement, as it has for many years? In effect, is private contract going to determine the availability of energy supplies, principally of natural gas in the U.S. market? On the other hand, the United States will be restrained, as I said, from imposing the embargo on uranium. And I take it also that when one talks about minimum import-export price requirements, the countervailing duty provisions of the U.S. law would not be available to American producers? At least I raise the question of whether that will be available now, in relation to energy commodities.

In the past several years, FERC has been following a number of policies that have posed de facto barriers to the sale of Canadian natural gas into the U.S. market, or it has imposed price restrictions that depart from the private contracts made. For example, FERC has followed the "as built" requirement with regard to Canadian natural gas access to American trunk pipelines. Presumably now they will not be able to follow that policy at the national level in the United States. Some of the opponents of the agreement have argued that Canadian energy supplies now have been thrown open to total American access. Of course, the agreement does not in any sense determine the extent to which Canadian energy supplies will be explored or developed at the initial stage. We are talking here about energy supplies that come within federal jurisdiction. The right to determine the rate of development of the producing provinces, I read from this agreement, has not been changed. Alberta can continue to set its own requirements with regard to maintaining its reservoir and with regard to production limits. Hydro Quebec, Manitoba Hydro, and New Brunswick Hydro can continue to make their own policies about the rate of development of their own resource within their jurisdictions. But when the commodities then are offered for sale in interprovincial and international trade, the provisions of the agreement will come into effect and the energy trade will be governed by it accordingly.

Let me conclude with some editorial comments, some overall conclusions.

First, as I said at the beginning, the elimination of tariffs will be important for Canada in terms of eliminating some American tariffs of concern to us. I think the more important general consequence, however, of eliminating tariffs over time is that we now will be able to get on to restructuring the Canadian economy to overcome the disadvantages we have imposed on ourselves for more than a century of having a much smaller market and of fracturing our industry into much smaller entities.

We are going to see the adjustment process that will take place. Certainly some firms will have to change their vocation, change their lines of business; some may even go out of business. On the other hand, they are now given an opportunity of access to a very much larger market, of being able to develop on the basis of economies of scale. And at last Canadian industry will be in a position to move to a more world competitive basis.

We have developed a highly structured dispute resolution process for dealing with a wide range of Canada-U.S. economic disputes. In this context, we will have more objective fact finding with regard to the matters in dispute. These are measured against legal criteria. In the case of the general dispute provisions, they are measured against the terms of the agreement. We have put in place a specific process — the Commission — a political process that can provide a forum in which settlement can be achieved. We have provided circumstances under which the pathological cases, the ones that can't readily be settled between the two countries, can be litigated and penalties for non-concurrence in the results of that litigation can be imposed by the party against whom the offence has been committed.

On the other hand there have been very substantial debates in the period leading up to the conclusion of the agreement about sensitive areas within Canada that should remain untouched. There are some good and some bad things from that. For example, with the exception of cable TV and postal rates, the area of popular culture has not been touched by the agreement in the way many people were concerned it would be. There is no adverse action with regard to social programs, as many feared. They have not been affected.

But there are some bad things too. Our governments in Canada will continue to be able to engage in subsidies, so we can continue to see heroic and famous examples of public planning, such as Sidney Steel, the heavy water plants, the two aircraft companies, and so on. Canadian governments are still going to have the opportunity to engage in non-viable activity of that kind and — of course, this is purely an editorial comment — I regret that. I would think we would have been better off to have the discipline of an agreement on subsidies, and I look forward to its early conclusion.

And we are still left with the supply management boards in the agricultural area. We still get the privilege of paying more for our beer, for our milk, for eggs and poultry. The sooner we can get away from that kind of distortion, the sooner we can deal with the agricultural problem as an agricultural income problem and stop elevating the market for all the rest, the better off the country will be.

So there is still an agenda to be addressed. I think the agreement is a considerable achievement, and I think it is one that is going to be of enormous advantage for Canadians.

Discussion

Jean-Luc Pepin

We have 15 minutes for questions to Mr. Macdonald. This is an open forum, so questions can be attributed by the press to the poser. Who wants to start?

Klaus Stegemann:

Mr. Macdonald, you said that the lack of agreement on the anti-dumping and countervailing duty laws was a disappointment to you. In particular you said that at one time you had hoped that the application of anti-dumping duties and countervailing duties would become redundant.

Donald Macdonald:

Anti-dumping duties only.

Klaus Stegemann:

I see. Anti-dumping only would become redundant in this country. I agree that this would be a nice thing, and I am disappointed in that sense. On the other hand, I wonder whether at any time there was any hope that this could be achieved? It seems to me when talking to people as early as 1984 in Ottawa, and later in Washington, that those involved in these negotiations, and those who were realistic had no hope that this could be achieved.

The next question is related to that. You mentioned that the process of negotiations will continue for five to seven years, which might lead to better results on anti-dumping or countervailing duties. I wonder whether there is any reason to be optimistic in that regard, because in the previous round, leading up to the agreement, Canada did have bargaining chips, but what would be our bargaining chips for the next five or seven years?

Donald Macdonald:

On anti-dumping, as to whether it could be achieved or not, I was a total outsider to the negotiations. But, as I said, the signals that came from the negotiations were that this was on the table, at least under discussion at the time. So I'd have to say that I think it still does remain an intelligent thing to do, since we don't apply anti-dumping duties to ourselves, between the provinces of Canada, although perhaps I'd better be careful in saying that. At Queen's Park they may decide that's a good idea as part of our national reconciliation. Since we don't do it in Canada, there would seem to be less basis to do it between Canada and the United States.

On the negotiations, I'll be candid with you. I remember clearly, Ambassador Murphy at one point addressing a public group in the city saying, if there were five years to negotiate an agreement, it wouldn't start seriously until the last six months. I bear that same criterion in mind and apply it to these five years of negotiations. I'm hopeful that expectation will be defeated and we might be able to do it much more quickly.

Duncan Allan:

In your view, does the standstill clause in the draft give Canada any real protection against the U.S. omnibus trade bill and the kind of running start that the Americans have for the next 14 months?

Donald Macdonald:

Well, Duncan, I'm not sure that it does. And here again, there are many things I'm going to have defer to the next speaker who was closer to them. I think there is certainly a gap there, where the provisions regarding changes in the trade laws, as I understand

them, are to apply after January 1, 1989. So that if action is taken in the next calendar year on that bill to change in any significant way the countervailing duty laws of the United States, then undoubtedly there will be a difficulty for us. One doesn't know the outcome of that omnibus trade bill. The suggestion is that it is going to be made so ferocious that the President will be bound to veto it. So the proponents of it can then take that into the next Congressional elections. I think we'll just have to wait and see. But I think there is a basis for genuine concern in your question, and I share that.

George Cooper:

Mr. Macdonald, what is your reply to those who would argue that the economic union, or near economic union, that is going to result from this Free Trade Agreement will inevitably and in time draw Canada and the United States so close together that, regardless of the protection from the questions of cultural sovereignty and so on, we will in 25 to 50 years become the fifty-first state for most practical purposes.

Donald Macdonald:

Well, George, I guess I would contest, first, the use of the term "economic union". The Common Market is an economic union in many aspects, in which there is the positive legal obligation on the part of the participants in the European Community to harmonize aspects of economic policies as well as to drop the tariffs between themselves. So they are under an obligation to harmonize manpower, social and fiscal policies, in a way that neither Canada nor the United States is required to do. We have no obligation nor indeed will Canadian governments want to harmonize Canadian policies with the United States. In that sense I think we will remain different societies. There will be different priorities followed and there will be no obligation whatsoever, for example, to change social policy or to change policy with regard to popular culture.

We always have been faced with the serious concern of being next door to the largest, most affluent, and one of the most creative economies in the world; and there is a challenge for us whether we go into a trade agreement with them or we don't. As to whether we maintain our political sovereignty, I don't think that Canada is a country that is held together by the twine and bailing wire of the remaining tariff system. I think we exist as a country because as

Canadians we believe in it, and that's what we want. So I think that opening up trade will in no sense reduce the Canadian national consciousness or our independence. Of course, every country in the world has to be concerned about dependence on one another; this has been no more evident than in the last 10 days or so. We've seen the impact on world capital markets of events bouncing back from one to other. We will continue to be in the position of being very much dependent on events, economic events in the United States and in the rest of the world. They are going to have an important impact on us whether we make this agreement or not. From my own standpoint, I would sooner put our relations with the United States on the basis of a carefully negotiated legal agreement than to leave it to the vicissitudes of power between the two countries.

John Crispo:

I think this is the third gathering I've attended since the agreement was announced. I always go away with a sense of frustration. What bothers me is that you can sit around and you can talk rationally about the issues, as we are doing, but it doesn't matter a bit in the public arena. We're engaged in a debate in which there is virtually no regard to the facts. I would say that about almost everything that's said on the other side: they lie about the alternatives; they lie about what this is going to do; and they lie about reasons for being opposed to it. It seems to me that what we have to come to grips with is not this kind of rational discussion. Those who believe in the agreement know that the future of the country depends on it. We've got to recognize that we're dealing with a group that will use every emotion, every piece of propaganda tactic, every scare tactic known to man. They have the media on their side, 90 per cent of them I believe. How do we translate the actual facts and amounts into something that's going to communicate? It just seems to me that's what it's all about. Unless we find a way to deal with emotional fear and innuendo, because they are very effectively engaged in a propaganda battle, the debate is going to be lost.

Donald Macdonald:

Mr. Chairman, I'm not altogether certain that that question may not have been rhetorical.

Jean-Luc Pepin:

Well you've done your best. Next one.

Edward English:

I think your conclusion may not be one of the main difficulties in selling this imperfect, but still good agreement. That is whether you can convince the business community first of all, and whether the politicians are really convinced, that it reduces the uncertainty of their decision making. Because that is the kind of argument, that's the only issue of validity I can find in all these emotional arguments coming from the opposition. Can you give us any further advice in dealing with that little bit of substance, in what is otherwise an extremely emotional issue?

Donald Macdonald:

Well, Ted, I think it's very difficult to do that any more than I have. As you know, either in your discipline or in politics, it's very hazardous to regard anything as being certain. It does seem to me that this should be viewed, not from the standpoint of what the ideal is. I think the ideal is important, and we had set out one view of the ideal in the Royal Commission report. I think we want to view it from the standpoint of the position where we are right now, or where we would be if there were no agreement. Do the provisions that have been negotiated here make life somewhat more predictable from a Canadian standpoint? Make it somewhat more certain that arbitrary action cannot be taken against us in the existing situation? I'd have to say yes.

Now, how much more certain? How far across this spectrum this gets us in terms of eliminating that uncertainty, I can't be sure. Therefore, I'm acknowledging that there is some element of uncertainty there.

Steve Hall:

Is it true that the U.S. domestic courts have the final ruling on trade policy issues?

Donald Macdonald:

I can't believe that that's accurate. I'm not here to comment on U.S. law, but I don't think there's any basis for that with regard to Canadian law. But if parties in the United States have got a right to appeal final decisions to the court, then how is it that final decisions with regard to safeguards in the United States are taken by the President, and are not appealable? There has been a wide spectrum of measures on the U.S. statute books for a long time, in which individual citizens might feel aggrieved on matters of trade policy, but don't have an opportunity to bring issues before the Supreme Court of the United States. Are Americans saying that for all the years in which they purported to be bound by the compulsory jurisdiction of the International Court of Justice — and they've now of course backed out of that — the ultimate right was to be determined within the domestic courts, not international ones? I don't believe that argument, and I think that Senator Benson, who is the source of it, is being badly advised.

John Bulloch:

A comment and a question for Donald Macdonald. I've just returned from an international conference in Japan, where over 50 nations gathered. And I can tell you that Canada is the envy of the world as a result of the Free Trade Agreement that has been negotiated. I wonder how many of you have looked at the trends that have taken place in the last year for trading partners, relative to the U.S. dollar. Most of them have seen their currency move upward between 50 and 80 per cent, and almost all of them are making more significant adjustments in their trade with the United States in one or two years than Canada will have to make in 10 ten years under the agreement.

With this dramatic change in the currency for Europe and Asia relative to the U.S. dollar, and our dollar tied to the U.S. dollar, what does this mean for investment for Europe and Asia in Canada as a result of this agreement?

Donald Macdonald:

Well I think it is hard to say. I think one could have been more categorical if, in effect, there had been a stronger procedure with regard to anti-dumping and countervailing duties. I think investment decisions, not only by Europeans or by Americans but even by Canadian investors, have been influenced over recent years by concerns about the protectionist attitude in the United States, and by the very practical conclusion: "Look, we want to be inside, we want to have access to that market, and if the only way to be absolutely certain of being treated fairly is to be inside that market with our plant, then that's what we are going to have to do." I am confident that's what motivated a number of major Canadian firms to locate entities in the United States — to deal with this protectionist sentiment.

Now this agreement, as I said previously, has brought us some way along the road so that we're in a better situation than we were in the past. But the fact remains that a substantial amount of public procurement in the United States still remains subject to the most arbitrary and chauvinistic of criteria. And there still exists the risk of countervailing duties against Canadian goods going into that market in a way that may be difficult to adjudicate. So, I think there are better prospects with this agreement, but it's not as good as would have been possible had those two areas of non-tariff barriers been more effectively controlled.

The Nature of the Canada-U.S. Trade Agreement

Simon Reisman

Looking over the distinguished list of speakers at this conference, my task has been lightened but the challenge made more daunting. The Institute for Research on Public Policy is to be congratulated for organizing this conference to examine the most important public policy issue facing the country.

What an array of experts! Looking around me I know I can count on Dick Lipsey to tell you that the agreement we reached on October 4 makes good economic sense. And if he doesn't convince you, Murray Smith or Paul Wonnacott will. I am confident that Don Macdonald and Jim McCambly will assure you that this historic achievement will benefit the country and make us richer. And I expect that Gary Horlick will tell you this agreement is good for Americans.

With all these experts around, there is little for me to do but to answer questions. Before I do, however, perhaps I should explain what we negotiated.

The agreement we reached three weeks ago constitutes the elements of a Canada-United States Free Trade Agreement. This will have to be fleshed out into a legally binding text. On all essentials, the agreement reached October 4 contains the substance of the accord. What you see is what you get.

Reaching agreement was an historic occasion: historic in terms of Canada-U.S. relations; historic in the development of international trade relations; and historic in its achievement of stability and the rule of law in trade relations between sovereign states.

What we achieved will, when implemented, stand as the largest trade deal ever negotiated between two countries. Canada and the United States are, after all, the world's largest trading partners.

Based on current trends, Canada and the United States will exchange more than \$200 billion in goods and services this year. And that is without a free trade agreement. Think what it can be in the future.

What we have achieved is a good deal for both countries. That is important. For the deal to endure, both countries must believe that their national interests have been satisfied. Both countries must benefit. As the Prime Minister reminded me, only a juvenile delinquent believes that you can make an agreement in which you get all the benefits to be received from upgrading and obtaining better productivity. Both sides benefit here and not at the expense of one another. This is a win-win agreement.

The agreement will make us richer and more able to pursue the finer things in life. It will lead to a more prosperous Canada, a Canada more able to enjoy a strong safety net of social programs, vigorous regional development programs and a vibrant Canadian culture. We fully safeguarded those areas most sensitive to Canadians and unique to the Canadian way of life.

The agreement we reached is a very large agreement. It cuts a broad swath across economic issues and will constitute major new undertakings in a variety of areas. The 35 pages of text we signed on October 4, once we flesh out the details, will constitute an agreement of about 200 pages, not counting the several thousand pages in the tariff annexes. It will contain some 20 chapters and up to 150 articles. Today, I will be able to do no more than paint a broad-brush picture of the key features.

These can be divided into four main themes that underpinned the negotiations: more open access; more secure access; a special regard for sensitive sectors; and trail-blazing for the GATT world negotiations. Let's examine each of these.

1. More open access

The agreement is a GATT Article XXIV agreement. That requires the elimination of substantially all the trade restrictions between us. I think we achieved that.

As of January 1, 1989, we will begin to eliminate the tariff; by January 1, 1998, both Canadian and U.S. tariffs will be bound free to each other. The general rule is 10 years, but we sought volunteers through consultation with industry for immediate or accelerated elimination. As a result, a good part of the job of elimination will be done immediately or over five years.

I know it is conventional wisdom to say that the tariff matters little today. Well, don't you believe it. Tariffs on many items of trade are still quite high. By removing the tariff on both sides of the border on thousands of items, we will give Canadian industry lower costs at home and lower hurdles to cross. It will increase the competitiveness of Canadian exports ranging from petrochemicals to furniture. It will lower prices to Canadian consumers of everything from food and wine to clothing and footwear.

The fact that so many Canadian industries agreed that they would benefit from faster phasing shows that many Canadian entrepreneurs are ready to take on the competition. Consultations with the Sectoral Advisory Groups also demonstrated that, with very few exceptions, Canadian industries felt that, given time to adjust, they no longer needed the tariff to protect them from American competition.

The rules determining whether goods will benefit from tariff elimination are based, in large part, on whether they are wholly of North American origin or whether imported goods have been sufficiently transformed to warrant change in tariff heading. This rule will be based on the harmonized system of tariff nomenclature so that it will be applied uniformly on both sides of the border. Some goods will also have to incorporate a certain percentage of North American content.

We have also agreed to eliminate, as between the United States and Canada, a number of tariff-related programs such as duty drawbacks, remissions and similar programs such as foreign trade zones. The tariffs and related programs on trade with other partners will, of course, continue to be governed by the GATT.

We have further agreed to eliminate all but a few remaining quantitative import restrictions and to rationalize customs procedures and technical standards. Throughout, we had a simple rule. We wanted to make the customs officer as unobtrusive as possible at the Canada-U.S. border. By 1998, most businessmen will regard him as that friendly fellow interested in his rule of origin certificate. No more hassling about duties, valuation, technical regulations, and the like.

Our goal of creating more open access also extended to government purchasing. As you know, government purchasing was not covered by the original GATT. In the Tokyo Round, we made a modest beginning. In the bilateral negotiations, we sought to open up all procurement — federal, state and provincial, civil and military.

We did not get the big procurement deal we sought. The Americans were not ready. They were not ready to take on little Canada. But we made some progress. Federal procurement rules will be

eased. This will open about \$650 million in Canadian contracts to U.S. bids, and almost \$4 billion in U.S. contracts to Canadian bids. The two countries have also committed themselves to a further easing of procurement rules in the future.

2. *More secure access*

We also wanted secure access. Canadians wanted to be sure that when they invested to serve the North American market, they would not be subject to the whims of American courts and regulators. They complained that U.S. trade laws were being used capriciously to harass them. They had lost confidence in the fairness of these laws. Without such security, investors would often be attracted to the safety of the larger market.

In general, trade law and practice, both national and international, afford far greater rights and protection to domestic producers than to exporters or consumers. What we have now achieved is a significant step toward correcting this imbalance. Here is what we did. The two governments have agreed to a unique dispute settlement procedure that guarantees fair interpretation and impartial application of their respective anti-dumping and countervailing duty laws. We have provided for greater accountability by regulators and investigators. In effect, we have established a watchdog to ensure that the laws are interpreted fairly and applied properly and that there is no arbitrariness in the application of those laws.

New limits are also placed on the use of emergency trade laws against import surges, with binding arbitration if necessary.

Either government may seek a review of an anti-dumping or countervailing duty determination by a bi-national panel with binding powers. Disputes with the United States will be assessed on the basis of U.S. law; those with Canada on the basis of Canadian law. Since this joint review will replace existing rights of review and appeal to our respective federal courts, this procedure will not add yet another level of litigation to the already complex and costly system of trade remedy law. Moreover, by virtue of their composition, these panels will be oriented toward practical, commercial policy considerations rather than fine points of law.

The success of this procedure will not be counted in the number of times it is invoked, but in the number of petitions it discourages and the number of politically inspired decisions it halts. That is the essence of a successful watchdog.

For the first time ever, the Americans have accepted the idea that a

bi-national institution with a neutral chairman will be the ultimate appeal against sanctions by them under their law. That is a formidable achievement.

We have also agreed that in the next several years Canada and the United States will develop "a substitute system of laws in both countries for anti-dumping and countervailing duties." It is intended that, by 1996, U.S. and Canadian trade laws will be replaced by North American trade rules that we develop together. The plan is that the existing system of unilateral laws, unilaterally interpreted and enforced, would be replaced by jointly formulated rules, jointly enforced within North America.

Additionally, we have agreed that no new laws affecting bilateral trade between the two countries may be passed without consultation and joint review and amendment, if necessary. That is also a big step and will act as a brake on protectionist forces and a basis for exempting each other from any new protectionist laws.

A Canada-U.S. Trade Commission at cabinet level will manage the agreement. Under it, officials will consult regularly to exchange information and resolve problems. Indeed, the institutional provisions are designed to avoid disputes. But as disputes arise, and they will, the normal technique of resolution will be through consultation and fact finding. Arbitration should be the exception rather than the rule.

There will be disputes, given our vast trade. So we have good provisions to resolve them amicably and expeditiously. I have discussed the process in respect of countervail and anti-dumping. For disputes on other matters, two tracks are available. If the Commission cannot resolve an issue, it can either send it jointly to binding arbitration or either party can seek the establishment of a panel to rule on the issue. If there is a dispute about emergency action to deal with import surges, binding dispute settlement is available at the instance of either party. In either case, we will have a definitive ruling by a neutral group within a matter of months. Problems that linger and fester for years should become a thing of the past.

Canadians will come to realize that it is a major step for this great power, the United States of America, to agree with its neighbour that in the last analysis, if a dispute develops between them, that dispute will be resolved by the two countries jointly and with a neutral chairman if we need one. It is an even larger step for the United States to accept the proposition that for critical disputes in respect of countervail and anti-dumping, the review and appeal process shall be subject to binding decisions by a bi-national panel presided over by a neutral chairman.

Finally, in the search for more secure trade access, we have a specific agreement to facilitate travel by business personnel. Canadians will be able to sell goods and services and service their sales as never before. As all of you know who have been harassed at the border when you went over to do business, this is no small achievement.

3. *Special sectors*

The agreement is generally organized along functional lines. But there will be four sectoral chapters for subjects that do not lend themselves to general treatment. The four sectoral chapters are agriculture, wines and spirits, energy, and trade in automotive products.

The agriculture chapter will establish improved conditions for trade in agriculture. All tariffs are eliminated. There will be new opportunities for exporters of beef, veal and pork — a major priority in Western Canada. We have secured undertakings from the United States not to intensify quota restrictions affecting Canadian exports of sugar-containing products and not to introduce any new restrictions on grains. And we have reached agreement that technical regulations and inspection procedures will no longer be used to frustrate trade. Meanwhile, Canada has maintained intact its marketing board system for dairy, poultry and eggs which Canadian farmers are so keen to keep.

There is a separate chapter covering trade in wines and spirits. You know that the Americans have long complained about the listing and pricing practices of our provincial liquor authorities. During the Tokyo Round, a step was taken to introduce non-discrimination.

We have now taken a more definitive step. Immediately for spirits, and over seven years for wines, we will phase out any discriminatory pricing and listing measures. Decisions on whether to sell California wines or Tennessee whiskey and at what price will be based on commercial considerations alone.

The agreement exempts Canada's brewers. This is a mixed blessing. We are all aware of the higher cost structure faced by the Canadian brewing industry. But I would hope that once interprovincial barriers to trade in beer have been removed, Canadians will want to see the benefits of open trade and competition extended to this industry as well.

The energy chapter is, in my judgment, the best chapter in the agreement. We have agreed to reciprocal concessions to remove

barriers to trade in oil, gas, electricity and uranium. Our objective was to assure the freest possible bilateral trade in energy. With this agreement, we will have secured our access to the U.S. market for Canadian energy exports — something we have sought to do for many decades.

At the same time, we have maintained our ability, should we judge there to be a real need, to take measures to prevent the over-exploitation of Canada's non-renewable energy resources and to make sure that Canadians have an adequate supply. We have undertaken in a situation of world shortage to treat our U.S. customers fairly.

It stands to reason that, if we want free and secure access for our energy products, we agree not to abuse our best customers should a real shortage situation develop. This has been criticized. Let me remind you that we already have similar commitments under the International Energy Agency. That is what good trading partners do for one another. They do not treat each other unfairly in time of emergency.

Nothing in this agreement more clearly crystalizes Canadians' views of themselves. Those who believe in protection and regulation, who want to hide behind a wall and keep their marbles in their pocket, worry about free trade in energy. Those who are ready to compete, to take on the world, think it's great. I can assure you that I make no apologies for this chapter. It is a good chapter.

I am equally satisfied with what we did on autos. As you know, I have a very personal interest in things automotive. The agreement does not threaten the automotive industry. In fact, the essential feature of the Auto Pact — duty-free access to the United States — will be more secure in the comprehensive deal which also stiffens North American content requirements. The Auto Pact is preserved and we have agreed on rules of origin that will provide new opportunities for employment and production in North America in this vital sector. Both domestic and offshore assemblers and producers of parts can prosper under the new arrangement. We honoured our pledge that we would retain the Auto Pact and only entertain suggestions that would make things better.

There is no chapter on culture. That is by design. The agreement will not in any way limit the capacity of the government to nurture Canada's cultural industries and policies. We have safeguarded fully our right in Canada to pursue unique cultural policies.

It was agreed that Canadian cultural industries would be exempt from the provisions of the agreement. Should any action by Canada in this domain harm the United States, it would be permitted to take action of equivalent commercial effect.

Minor adjustments were made to deal with cable re-transmission and postal rate discrimination with respect to public interest magazines of wide circulation. We also agreed that printing is not a cultural industry.

4. Trail blazing for the multilateral negotiations

The agreement we reached on October 4 is not just an agreement for Canada and the United States. It is an agreement that strikes out against protectionism worldwide. It is an example to the world and a catalyst to the Uruguay Round of multilateral trade negotiations. What we achieved together bilaterally we will seek to carry forward with all our trading partners at the GATT table in Geneva.

This is particularly important in two areas: trade in services, and investment. These have not traditionally been covered in GATT Article XXIV agreements. In today's world, however, where capital markets are global, as has been so dramatically demonstrated over the past few weeks, and where more than half the labour force is engaged in service activities, it is important that we begin to develop good international rules. I think we have made a strong beginning.

We have established for the first time ever a contractual code of rules to cover trade in services. Any new measures taken by either government will have to conform to the reciprocal undertaking to extend national treatment to each other. Additionally, we have made some progress in rolling back existing barriers in financial services, enhanced telecommunications, architectural services, tourism and one or two other sectors. More such sectoral accords may be reached in future, and the agreement looks forward to further progress.

We also concluded an investment chapter. For Canadians to reap the full benefits of this agreement, there will need to be a plentiful supply of capital. Canada has traditionally financed major expansion with the help of foreign investment. What we have done is agree to provide national treatment. Any controls that a future government wishes to impose on investment practices will have to be applied to both Canadian and American investors without discrimination.

5. Issues for the future and lessons from the past

Reaching the deal required compromises. We did not get everything we wanted. The Americans did not get everything they wanted. I have already mentioned that the result on procurement was disappoint-

ing. The Americans wanted very tough rules on subsidies for us — but not for them. We turned them down. The Americans wanted a chapter on intellectual property. We had such a chapter, a good chapter, but the Americans tied it to specific commitments on pharmaceuticals that we could not give, and the whole chapter fell off the table.

In effect, we have left some room for improvement and for further negotiations. We will continue to work away at these issues, both bilaterally and multilaterally. Progress on these issues will be helped, however, by the knowledge that we have reached a new and far-reaching framework to govern trade and investment in Canada and the United States.

This agreement, if approved by Congress and by our Parliament, will create a whole new environment in which Canadians work and live. It will create new opportunities for jobs. It will encourage application of more advanced technology. It will increase the incomes they earn. It will encourage Canadians to seek their futures in Canada and attract the best from abroad. In general, it will create a positive, constructive kind of environment with new opportunities for expansion and growth.

But this agreement is not a radical departure from the past. It builds on 50 years or more experience in Canada and around the world in cutting barriers to trade and investment. And that experience has been uniformly positive.

It also builds on the provisions of past agreements. In putting the agreement together, we took inspiration from similar agreements reached across the Atlantic in Europe and across the Pacific between New Zealand and Australia.

It builds on previous trade agreements between the United States and Canada dating back to 1935, including the Auto Pact, the Defence Production Sharing Arrangements, the Air Agreement and others. We borrowed from the work of the International Joint Commission.

And it builds on our commitments to each other under the GATT, the OECD, the International Energy Agreement and more. The habit of cooperation between Canada and the United States is not new. We do live next door to each other. We do share the longest and most open border. We have more commerce between us than any other two nations.

But we knew we could do better. We thought we could achieve even more open and secure access to each other's markets. The government sought to give Canadian manufacturers secure access to a

market of some 250 million so that they could plan and invest with confidence. And we achieved those goals.

More than three years ago, long before I took on the challenge of negotiating this agreement, I told the following to a conference at the Brookings Institution in Washington. I said:

If the United States and Canada were able to work out a free-trade agreement, it would be a good thing for both countries and a good example to the world. It would make both countries richer. It would also make us better neighbours, because it would remove many of the irritants about which we have been squabbling for many years.

A free-trade agreement would not weaken Canadian sovereignty or Canadian resolve to remain independent. Indeed, by enriching Canada and by raising its confidence and its performance, the agreement would strengthen Canada's purpose and its ability to survive as a strong free nation.

I believed that then, and I believe it even more today.

For someone who worked for 40 years to open markets and reduce barriers, it is a singular distinction to be allowed at the end of my career to have an opportunity to negotiate this agreement. And I very much appreciated having this opportunity. But the real credit must go to Brian Mulroney, who had the vision and the courage to see this challenge through to the successful negotiation of this agreement. This is his agreement and, come what may, he has earned his place in history.

Protectionist and inward-looking forces will now try to mobilize to defeat this historic agreement. They will not succeed. Those who have confidence in Canadians and see a great future for Canada will fight hard. I am confident that they will overcome.

Discussion

Jean-Luc Pepin

John Crispo:

Simon, I got a very timid response from a guy who's not usually timid, one Donald Macdonald, when I asked what do we do now with the emotion that's so much of this. I know you are a fighter; now you tell me what to do.

Simon Reisman:

John, you just keep doing what you're doing. You're doing it very well. I think that Don Macdonald didn't answer your question from the platform, but he's doing what needs to be done, and he's mobilizing forces and he's joined groups. One of the things that bothers me about a group like this, and it's a splendid group, is that I think for the most part we're speaking to the converted. You're all knowledgeable, you're all enthusiastic, you're all rational, you're all informed. But why are we talking to each other? Each of you should be out there with your own group on your own platforms in your own constituencies — by that I mean office or university or business or wherever.

But I do want to add this: the battle will engage on a number of fronts. There is the rational intellectual front, and Dick Lipsey will be providing us with the firm intellectual foundations and analysis to conduct that battle.

John Crispo:

It sounds just like the answer I got before.

Esmond Jarvis, Canadian Wheat Board, Winnipeg:

I'm a little reticent to enter into this question after that exchange, but I haven't been to three meetings on this subject, and I want to get a little clarification.

In terms of the grain business, there is no question that we have to be excited about the possibility of this agreement. We are very dependent on world markets, shipping to over 60 countries. We have been shipping a little bit to the United States, but that's the wealthiest market in the world, and it's right next door, convenient and handy. They like our product, and we can compete with anyone on service and quality in the world market.

My question is reflecting the kind of questions that are in the grain sector: How real is this possibility? At the present time we get letters from American senators complaining about what we ship to that market. Now we don't have a balanced situation in the current market account to acknowledge that, and this agreement provides for that possibility. But, do you think we could really ship substantial quantities of grain into that market without the farm lobby being effective in causing it to stop?

Simon Reisman:

Well, as you know, we've got some undertakings in the agreement with respect to shipments of grain and that gives us some security of access that we haven't had as firmly before. You're asking me to make predictions. I will say that it is always hard to make predictions, especially about the future. I don't want to claim that as my line; I think that was used by somebody else.

Quite clearly, they are not going to accept unlimited quantities of Canadian grain, particularly if there are elements of subsidy involved in it. So we have to be pretty careful what we do and how we do it. We do ship a good deal of grain there now and I think if we behave in a circumspect manner and avoid abusing that market, we can continue to see growth in it. As you know, we don't allow U.S. wheat, for example, into our market. But we have given an undertaking that when price support levels become more equalized between the two

countries, we will ease up on border controls on grain from the United States.

While we're on the subject of grain, I think there is a consequence of the agreement we reached, affecting wheat and wheat flour, and it comes about in this way. We have undertaken to remove the tariff on processed foods over a period of 10 years, and we discovered — and the food processors made sure that we knew this and knew it firmly — that there is a large handicap to Canadian food processors who use wheat and flour, affecting their costs, because of the two-price system for wheat and flour in Canada. We will have to do away with that, and we will have to do away with it in a way that does not impose any new burdens on Canadian wheat growers. They have enough on their hands as it is. The government understands that and will do it. That, as I understand it, accounts for about 85 per cent or a little more of the discrepancy in input costs in the food processing industry in the two countries; doing away with the two-price system will help. Additionally, where we retain the marketing board systems for dairy, poultry and eggs, and where we do have some modest quotas, those quotas will be allocated in such a way to the food processors that it will help them with respect to input costs.

Now that goes a little beyond your question and I don't think I can go beyond that.

Mr. Bullock:

Simon, this is partially in response to John Crispo's comment to you about how we deal with the emotion that is so much a part of the free trade debate. Perhaps I could throw out a few numbers that I've made available to you, but that members of this audience may not be as familiar with.

Our organization conducted 42,057 face-to-face interviews with the owners of small to medium-size companies, in every corner of Canada. We got the data by trade, by province, by age, by size and made them available to Simon and his negotiating team, so that he could be sensitive to those sectors that are more vulnerable. Across Canada in small business, there are three perceived winners for each perceived loser, on a national basis. But in every case where we determined a sector to be more sensitive, there were always more winners than losers. In other words, the question of competing in a more open economy is a management challenge. This trade agreement will be a benefit to everyone who manages well, improves their

quality, upgrades their technology, becomes more international. So, what we can say to the general public is factual: 70 per cent of all the new jobs in 1985-86 were created by small business. And the small business community would be very substantial winners under the agreement and expect to create even more jobs in the future. And that's a fact, based on face-to-face interviews with the owners of 42,000 companies.

Government of Ontario Representative:

Concerning the services chapter, I have a couple of questions.

Simon Reisman:

As far as prudential, fiduciary, consumer safety, health and all that, we're free to do what we need to do, as long as we don't do it in a way where we introduce protection under the guise of looking after people's safety and welfare. It's very plain and clear, and when we get to the legal text, you will be very satisfied on that.

The services chapter, other than the sectoral appendices, is "future looking". So anything you're doing now, you can continue to do. Now, if you are reviewing and modernizing some of those rules, laws and regulations in respect to service industries, you may of course do that, and bring them up to date, as long as you don't make them more restrictive and more discriminatory than they are today in respect of our trading partner. This is a very flexible, reasonable instrument, as you know it would be when the federal government negotiates it!

The services chapter is subject to the general dispute settlement mechanism that is available to all the elements of the agreement. But, as you know, there are really four different kinds of dispute settlement mechanism within the agreement. The services chapter will be subject to the general dispute settlement mechanism, which Donald Macdonald described in considerable detail and, I might say, fully accurately.

Donald Macdonald:

Simon, I raised a number of questions when talking about the energy agreement, for example, whether countervailing duties

would apply to energy exports. Does the agreement lift the energy sector out of the special trade remedies on both sides of the border?

Simon Reisman:

It does not. It's one of the chapters. It's an integral part of the agreement, and the general provisions apply to it as well.

Daniel Roseman:

Since the mandate of the Institute is to stimulate informed public debate, I'd like to put a question with respect to one of the areas that have been criticized in the agreement. This is with regard to investment. One of the concerns, as I understand it, is that Canada has bound itself to the United States with respect to foreign investment without the Americans binding themselves in return. There are a number of foreign investment restrictions in the United States. For example, there are 22 states that have legislation screening foreign investment. The U.S. trade bill now before Congress would provide for screening foreign investments, mergers, takeovers, etc., and would also block indirect takeovers. In the trade agreement we have found ourselves committed not to screen indirect takeovers of foreign-controlled firms by American companies. In the United States there was a case where Dominion Textiles wanted to buy Burlington Industries and there was substantial opposition to that. I guess that what it comes down to is whether the rules are going to be the same for both sides.

Simon Reisman:

The obligations in the investment chapter are reciprocal. Both countries will apply them, and the grandfathering will also apply to both countries. The agreement, when put in final legal form, will indicate what that is.

Daniel Roseman:

Will the agreement permit American screening of Canadian investments?

Simon Reisman:

They don't have any screening now, and they're not allowed to have any. It will be very clear in the agreement that they won't have any. In that respect, Canada will continue to have the right to screen all significant direct takeovers, and I regard a significant takeover to be one that has a capital value of over \$150 million. I know other people think otherwise, including *The Toronto Star*. But I regard direct investments of over \$150 million as significant, and they can be screened as they have in the past in Canada. The United States will have no screening at all. And I can tell you that we looked at all the things that they needed to grandfather, and the things that we wished to grandfather, and we explored that with our SAGIT and our ITAC groups, and with our business people. They're pretty comfortable about the situation as far as access to the United States is concerned. Having that formally put in place, contractually, satisfies a good number of Canadians in that respect. I think that, by and large, we have been more restrictive than the Americans. I know there have recently been all kinds of noises in the United States about the desirability of screening Japanese and other investment, but that has been more in the area of discussion than in the form of legislation. And what we have here — it will be made very clear when we give you the final text — is a lot of security now in terms of our investment access to the U.S. market.

Daniel Roseman:

A supplementary. In the provisions regarding investments, there is a derogation for national security. Has that been nailed down in any way?

Simon Reisman:

Well, there is a national security derogation in the GATT, and there is one in this agreement, and there's always the question as to what you can do under it. I think there is an admonition in the agreement, or will be, that says don't use it for protective purposes. Of course, any of these derogations is subject to the dispute settlement mechanism, so if there's any attempt to use it to disguise a protective measure, then we have the normal defences in the agreement.

Richard Lipsey:

Could you enlarge your comments in regard to automotive trade under the agreement?

Simon Reisman:

We've all heard a good deal of noise from the other side of the border, coming from the U.S. labour union movement, from the parts makers, from state governors, from Congressmen and others, about their unhappiness about the present rules, Auto Pact and other rules, in relation to the automotive industry. In the last few years, Canada has been very imaginative in the use of remissions, drawbacks, and other tariff reliefs to encourage the so-called transplant companies, Japanese, Korean and others, to come into Canada and locate facilities here. The Americans have become increasingly uneasy about this, particularly because a good deal of the output of these new enterprises is destined for the United States.

My own feeling, like the feeling of many others, is that in the absence of an agreement that sets out some clear understandings on these matters, the Canadian auto industry is vulnerable. In a meeting that I had last week with Premier Peterson and Bob White and some of the people in the industry, that point was made emphatically by several of the people around the table, including the parts makers. I have no hesitation in talking about that meeting, because Mr. Peterson and Mr. White have been talking about it in their terms. What I can tell you is that the Chairman of the Board of the Canadian Auto Parts Manufacturers' Association spoke at some length, and very rationally, about the dangers and the concerns of failure to reach an agreement, the fact that there is no status quo to go back to, and the fact that the industry is vulnerable. Strangely enough, the answer he got from Mr. Peterson was: "Well that's speculating about possible political developments on the other side of the border. I don't think we should allow ourselves to be guided by that." I would say that he had his head in the sand.

Failure to get this agreement will mean a great deal of vulnerability, not only in the automotive sector, but all across the board. There's no question whatever that the Americans are heading in a protectionist direction. Whether this will find its way through the omnibus trade bill or in another way, until the United States gets its international accounts into better balance the threat of increased protectionism is

there. I don't think there's any doubt whatever that if we don't get this agreement in place, there is no turning back to where we were. There's no turning back to some status quo, which in the minds of some has elements of security in it. I think failure to make a deal will expose us to real dangers on the protectionist front in the United States, and I think that this has been made even worse by the recent debacle in the stock markets. We know what happened during the early '30s. We know all about the Smoot-Hawley tariff. The real question is whether you are going to be on the inside of a wall or on the outside of it.

Debra Steger:

One of the points I heard Don Macdonald make, that I heard you object to, was his comment about the standstill provision. I think he said something to the effect that he assumed that the standstill provision would only kick in on January 1, 1989. And you suggested that the standstill provision is in effect right now. Can you tell us what the standstill provision is about and specifically what impact you think it will have on legislative and other regulatory developments in the United States? Particularly the omnibus trade reform bill that is currently before Congress, and also any other cases that may be initiated or may be going on in the United States between now and January 1, 1989.

Simon Reisman:

Well, the standstill is what it is, nothing more and nothing less. It is designed to deal with the situation between now and the time the agreement comes into force. We expect the agreement will come into force on January 1, 1989, and you have a difficult period between now and then, when consideration will be given to the agreement in both countries, where they have their systems for examining it and we have ours. There are always dangers during such a period that the countries will be doing things that exacerbate the problems of examining the agreement, preparing the implementing legislation and getting it into effect. So what we did is agree to a standstill where both countries will undertake to try to live, within the full extent of their executive authority, as if the agreement were already in force.

In the United States they have a division of powers, which means the Administration can't control the emergence of legislation en-

tirely, but it can influence it. And in some instances it can determine whether it will allow it or use a veto, or whatever techniques it has for influencing it. But what the U.S. Administration understands clearly, and what we understand clearly, is that we had better not engage in beggar-your-neighbour policies, particularly during this critical period when the agreement is under consideration.

Now how will it affect the omnibus trade bill? It should affect it favourably from our point of view. Will it? We'll have to wait and see. If it doesn't, there's going to be a lot of trouble. Here we are getting ready to put this great thing into effect. If the Americans should pass an offensive trade bill that affects us, what will the consequences of that be? I don't think we would have an agreement. If the Americans have a restrictive trade bill that applies to Canada, I think the chances of getting the agreement through in Canada will be severely inhibited.

Questioner:

Mr. Reisman, you mentioned that the chapter on intellectual property had been dropped because the Americans wanted commitments on pharmaceuticals. Now we've all heard a lot about the proposed drug legislation here. Would you comment?

Simon Reisman:

Everybody knows about Bill C-22. The Americans know about Bill C-22. And Bill C-22 is out there, and the Senate is playing around with it, and God knows what will happen to it. But quite apart from Bill C-22, in the intellectual property chapter the Americans were seeking obligations of a very, very extensive and profound kind, right across the board, including pharmaceuticals. And, as you know, the rule in the United States is a 17-year rule of protection for property rights in the field of pharmaceutical patents, and they do not allow for compulsory licensing. They do have something like that which they operate through their anti-trust, but they don't allow for compulsory licensing in the way we do. They wanted restraints on that, and we just wouldn't give them. There were several other matters in that chapter related to "first to file," and "first to exploit." The Americans wouldn't recognize the "first to file" right that we have, and they insisted on including us under section 337 of their trade law, which is used to punish people who don't respect the intellectual

property rights of American citizens. If we had an intellectual property chapter, we wanted complete exemption from 337, so there were a number of elements. But the pharmaceutical thing was the big thing. Sitting right at that table on the Saturday before the President sent his letter to the Congress, we had that intellectual chapter in front of us. We had a very, very vigorous debate, and we couldn't agree. So the chapter fell off the table.

Question:

How would this agreement affect provincial trade practices?

Simon Reisman:

Well, as far as I know, this agreement would involve changes in provincial practices only in respect of the liquor boards. There are other obligations that would involve them, but they're later on. They're forward looking. What do the Americans mean, what does Clayton Yeutter in particular mean, when he talks about the provinces being committed? I think he was a little out of date when he made that observation. As you know, he complained bitterly that I held up the agreement, that it could have been handled six months ago. All I had to do was take the document they had and sign it. We would have had an agreement six months ago, but none of you would have been very happy with it. No, I think he was speaking out of turn a bit on that. We're going to go through the processes that we have to go through in Canada. Probably over 95 per cent of the agreement, maybe 97 per cent, is in the federal domain. Treaty-making is clearly in the federal jurisdiction. The present government has a considerable majority, when last counted in the House of Commons, and the likelihood is that if it wanted to put the agreement in place, it could put it in place, and do what it needs to do in respect to the provinces. I don't know what will happen in respect of wine, but I don't believe that Premier Peterson will hold up the agreement because of wine.

There is a case before the GATT now. The results of that case will soon be public knowledge. I expect that when it does become public knowledge it will turn out that the agreement we negotiated with the Americans on wine, providing for a phase-in and providing for a variety of other safeguarding measures, will be a good deal more lenient on Mr. Peterson and his situation with the liquor board than the GATT decision will be.

Question:

In relation to the omnibus trade bill, could the United States exclude Canada on the basis of the free trade arrangement and still not contravene the rules of GATT?

Simon Reisman:

The answer to that is yes. Certainly in my judgment, the answer is yes. The very essence of a GATT Article XXIV agreement is that the partners to such an agreement treat each other differently, and better, than they treat others. That's what the European Common Market does, that's what the EFTA does and the other bilateral free trade area agreements, between Australia and New Zealand, and so on do. So I would say yes. But I'm not predicting.

Question:

Can you do it ahead of the fact? The omnibus trade bill will be passed before the bilateral agreement comes into force.

Simon Reisman:

There is a provision in our agreement that if either country considers changes in its trade laws, unless they specifically name the other country in the legislation, then the other country is exempt. Now that is future looking. I would think that you're asking a legal question. I would say that if the Americans pass a trade bill prior to the time of this agreement coming into effect, and they choose to exempt Canada, from my knowledge of the way the GATT works and how the GATT is treated, and the various bilateral or group arrangements under Article XXIV for free trade areas and customs unions work, then it would be perfectly in order and it would not be challenged. But that is my view.

Question:

There is no general clause on abrogation. Will there be in the final version? I would also like to ask what is meant on page 6, in the

section on anti-dumping and countervailing duties, regarding the termination of the agreement in 60 days. What does that mean?

Simon Reisman:

What you have there is the same question that was put to me earlier about the standstill, and what happens if there are changes in the law, and what happens to the omnibus trade bill. If the Americans were to pass a trade bill that offended profoundly against the spirit and purposes of this agreement, then clearly we would get out of the agreement. That is what that is meant to say. On your first question about termination or abrogation, I think you are familiar with what the American trade law says today. Any agreement entered into under American fast-track trade law has a six month termination clause in it, and that's the law of the land in the United States. Every agreement they have entered into has that. If I am not mistaken, the GATT, which is in effect by virtue of the protocol of provisional application, has a six-month clause in it. It has been in effect for 40 years. The U.S. agreement with Israel has that clause in it. Any other agreements the Americans have entered into have that clause in. The reason you don't have any specific dates in there is that if a date were put in there, the Americans would have no option but to put in the provision that is in their trade law; but they know that that is not a very good provision, so what they are contemplating is that at the time they prepare their implementing legislation, they will be discussing with the Congress a rather different kind of termination provision than the one they have now in their general trade law. What will come out of that interchange they have with the Congress, nobody can predict. But we won't really be able to put in a firm provision of that kind, dealing with that subject, until the Americans have prepared their implementing legislation and have consulted with Congress and have some kind of agreement with them as to what kind of termination or abrogation clause to put into this particular agreement. Does that answer it?

Jean-Luc Pepin:

Unfortunately, Simon, this is all the time we have. I thank you on behalf of everybody for being so frank, so friendly, so charming.

III
Analysis of the Agreement and Issues
in Implementation

The Canada-U.S. Agreement In An International Context

Murray G. Smith

All of us face some difficulty in commenting on the Preliminary Transcript of the *Elements of Agreement* that was concluded on October 4, 1987 in Washington. My task is particularly difficult because we have had two authoritative overviews provided by the Honourable Donald Macdonald and Ambassador Reisman. Based on the broad outlines of the agreement, however I propose to compare it to some of the other regional trading arrangements that exist around the world. I would suggest that in Canada we tend to look at these issues in a purely Canadian or, at best, a purely North American context, and tend to ignore experience with regional trading arrangements in other countries. I am also going to touch on an issue of some sensitivity, at least on the Canadian side — the energy provisions of the agreement.

Although there are certainly remaining questions to be clarified when the legal text is introduced, I believe the basic character of the proposed trade agreement is clear and that we can tell a great deal about its ultimate architecture, not only when the text is released, but if and when the agreement is fully implemented by the end of the century. The first observation I would make is that the proposed Canada-U.S. Free Trade Agreement is a classical free trade area consistent with Article XXIV of the GATT. Specifically, as the other speakers have indicated, it provides for elimination of tariffs over 10 years; and there are clear predictable rules of origin based on changes in tariff classification — which will determine which goods qualify for duty free trade between the two countries.

People's eyes glaze over when one mentions rules of origin. But this basic plumbing of a free trade area has policy significance that is often overlooked despite two years of the free trade debate.¹ The essential

feature of a free trade area is that each country continues to pursue independent commercial relations with respect to third countries. Protecting this independence in commercial policies requires clear rules of origin and the rules of origin in this agreement appear to be very clear and predictable. There is much less uncertainty and paper burden than exists in other free trade areas, such as the European Free Trade Association (EFTA) and in the bilateral free trade agreements that exist between EFTA countries and the European Community.² Nonetheless, I was bemused to see customs officers parading on Parliament Hill protesting free trade, because I am certain that more, not fewer, customs officials will be required to administer the rules of origin in the Canada-U.S. free trade area.

Canada and the United States are also following previous experience with free trade areas by exempting portions of the agricultural sector. The GATT rules and past precedents for free trade areas permit the retention of quotas for those agricultural commodities subject to supply management regimes. Indeed, the United States and Canada contemplate much more sweeping liberalization of agricultural trade through the Uruguay Round of GATT negotiations than will occur through the bilateral agreement.

There was, however, general agreement on both sides about the goal of creating a free trade area right from the start of these negotiations. A much more contentious set of issues concerns non-tariff barriers to trade, rules for unfair trade, policies affecting direct investment and barriers to trade in services. These issues have been treated with varying degrees of effectiveness in other regional trading arrangements. Previous free trade areas, such as EFTA, devised rules of competition to deal with non-tariff barriers to trade in goods and to deal with unfair trade issues. The basic philosophy of EFTA was to focus on trade measures that created distortions to competition.

The EFTA experience has influenced the GATT arrangements with respect to some non-tariff barriers; in turn the Canada-U.S. agreement builds on existing GATT rules. For example, the obligations with respect to standards and government procurement in the Canada-U.S. agreement build on the GATT codes reached during the Tokyo Round. That means, for example, that Canada will retain the bilingual labelling and metric sizes that Canadians hold so near and dear. In the area of procurement, I think it is apparent from the discussion this morning that much less was achieved than was initially contemplated. The United States restricted coverage of purchases such as urban transit equipment under the agreement and the purchasing practices of the Canadian provinces are not covered.

Except perhaps for the European Community, there is little prior experience in regional trade agreements in dealing with disputes over subsidies, countervailing duties and other unfair trade issues, trade in services, or investment issues. All these issues proved very difficult in the bilateral negotiations. And the issue of trade disputes threatened the collapse of the talks, at least twice, in the final two weeks.

Drafting rules of competition to deal with subsidies and allegations of unfair trade practices and rules to liberalize trade in services and investment policies were the major challenges in the Canada-U.S. talks. The two models that provide the most relevant basis of comparison are the rules of competition, contained in the Stockholm Convention that created EFTA, and the provisions of the Treaty of Rome governing the relevant issues in the European Community. Neither of these models provides a perfectly appropriate analogy for Canada and the United States. Instead, the bilateral negotiations have produced a hybrid that shares elements of the EFTA system and the EC system and includes some unique elements.

One area of great difficulty in the Canada-U.S. talks involved the development of rules and dispute settlement processes with respect to unfair trade in the application of anti-dumping and countervailing duties. Other speakers will be addressing the issues of dispute settlement provisions in the proposed agreement in more detail. In passing I will note that the dispute settlement provisions in the Canada-U.S. agreement are more formal than in other bilateral free trade areas, including the EFTA-EC bilateral agreements, the U.S.-Israel agreement, and the Australia-New Zealand agreement. For example, the U.S.-Israel agreement provides only for a conciliation process and all the bilateral free trade areas cited rely on consultation between the member governments to resolve disputes. I wish to focus on the question of negotiating new rules governing dumping and subsidies, a question that is deferred for five years in the proposed agreement.

It has been clear for some time that, unless the bilateral negotiations could devise an acceptable process for controlling the use of subsidies, there was little likelihood that the U.S. Congress would accept dismantling of the countervailing duty apparatus for bilateral trade. The European Community has a mechanism for disciplining the use of subsidies by the governments of member states, but the EC approach involves yielding authority to a supranational agency to disallow spending programs by national governments. A bi-national agency, which could disallow subsidies programs by both national and sub-national governments in both countries, could offer eco-

nomic benefits to Canada and the United States by preventing the bidding wars that currently occur to encourage investment in particular jurisdictions. In this regard, I agree with the Honourable Donald Macdonald in his observations this morning, but I am doubtful that Canada and the United States will agree to grant a supranational agency the right to disallow subsidies programs.

I am reasonably optimistic, however, about the prospects for negotiating new bilateral rules to govern anti-dumping and countervailing duty laws. It is my view that U.S. protectionism will wane in intensity as the U.S. trade deficit begins to turn around. In the early 1990s, the United States will be obliged to run a trade surplus to service its mounting foreign liabilities, just as Canada — with proportionately larger foreign liabilities — must now, and for the foreseeable future, run a substantial trade surplus. My chief concern has been that the protectionist forces operating in the United States would leave a legacy of protectionist trade laws that would be difficult to reverse. Thus, I believe the political climate could become more conducive to Canada and the United States negotiating the removal, on a bilateral basis, of some of the more protectionist provisions of the trade laws of both countries. But I believe that the two countries are unlikely to agree to implement the kind of supranational regulatory regime for subsidy practices that exists within the European Community. It is because of the sovereignty concerns of both countries, that Canada and the United States seem, to me at least, likely to pursue variations of the EFTA approach of focusing on distortions to competition.

In the services and investment areas as well, the proposed Canada-U.S. agreement goes further than the EFTA-EC bilateral agreements but falls well short of the full commitments to national treatment that apply within the European Community. Many existing laws and measures that deviate from national treatment are grandfathered on both sides of the border. There is no parallel within the European Community, other regional trading arrangements, or even the GATT for the broad exemption for cultural industries which is a feature of the Canada-U.S. agreement. The controversial postal rate subsidy issue, including the provision that will be retained after the Canada-U.S. agreement is implemented is, in my view, a contravention of the GATT. Furthermore, the investment provisions of the agreement permit Canada to continue screening direct acquisitions by Investment Canada. I suspect that is a provision that gave some pause, at least to the Secretary of the Treasury, on the U.S. side.

Turning to the issue that has been among the more controversial on the Canadian side, it is worth considering the provisions of the

agreement pertaining to energy. These provisions have appeared to be the most sweeping to Canadians and have raised serious public and emotional concerns. The language of the energy section of the Elements document is a bit misleading, in my view, but my interpretation of that language — and what I understand to be the draft agreement that lies behind it — is that, in fact, the energy provisions can be characterized as a set of special exceptions from the general obligations to eliminate tariffs and quantitative restrictions and to liberalize investment policies and services trade. On the U.S. side, there is only a limited exception on the prohibition on export of North Slope Oil. On the Canadian side, special investment provisions are retained as well. Both countries retain the right to impose quotas under the various provisions of Article XX of the GATT, including conservation of exhaustible resources.

What are the obligations under the energy provisions? As I understand them, there are, first of all, to be no import duties, export taxes, or quotas imposed at the border that could create differences in domestic and foreign prices for energy. Second, there will be no non-tariff barriers to energy trade, such as the U.S. uranium enrichment restrictions or Canada's uranium processing requirements. Third, in the event of supply shortages, it is agreed that government rationing of energy will be on a proportional basis, determined through using a formula based on the recent pattern of exports relative to domestic consumption. In any event, however, the International Energy Agreement (IEA) takes precedence over the Canada-U.S. free trade agreement and, in the case of a severe supply shortage in oil, Canada might actually be obliged to increase exports of oil under the IEA, not simply prorate the reductions or rationing process. Finally, there is an agreement to consult on regulatory measures affecting transportation and distribution. It appears there are no obligations with respect to provincial resource management policies. The provisions in the agreement focus on energy trade and pricing; they do not impinge on provincial jurisdiction over resource development. Indeed, the pricing policies of provincial electrical utilities may not be constrained, except for the potential application of existing countervailing duty laws.

The energy provisions are controversial in Canada, but they appear less revolutionary to trade policy specialists. The proposed energy trade provisions parallel the sectoral proposals made by Canada during the Tokyo Round of GATT negotiations. Canada's sectoral proposals of the mid-1970s — not to be confused with the bilateral sectoral proposals of 1982-83 — involved the offer by Canada to eliminate export controls and taxes on natural resources and

also to make commitments on security of resource supplies in return for elimination of foreign tariff and non-tariff barriers to processed resource products. The Canadian Tokyo Round proposal was not taken up by our trading partners which disappointed most resource industries, but particularly the petrochemical industry in Western Canada. It would appear that Canada's negotiating objectives during the Tokyo Round have been achieved on a bilateral basis at least in energy. Unfortunately however, a similar result was not achieved in lumber trade, where Canada's export controls on logs and the Memorandum of Understanding on Softwood Lumber, imposing export taxes or equivalent measures on softwood lumber from Canada, were grandfathered. I expect that the effectiveness of the new dispute settlement mechanisms will be tested on the lumber issue in the future.

There is a much larger question about the implications of the proposed Canada-U.S. Agreement for the multilateral trading system. There is a clear presumption that the Canada-U.S. Free Trade Agreement is compatible with Article XXIV of the GATT. Beyond compatibility with GATT, however, there is a question about how Canada and the United States will conduct their respective multilateral trade policies. Elsewhere I have argued that the Canada-U.S. negotiations could be a catalyst for the Uruguay Round and that a Canada-U.S. free trade area is likely to be much more outward looking than a customs union like the European Community.³ How outward looking the arrangement will be, however, depends very much on the future conduct of Canadian policy.

In conclusion, I would suggest that the proposed Canada-U.S. free trade agreement is much closer to the model of the European Free Trade Association or the EFTA-EC bilateral free trade agreements than the more sweeping economic integration of the European Community. As I stated at the outset, the proposed Canada-U.S. free trade agreement is a classic free trade area. Canada and the United States propose to go further than the EFTA and the EFTA-EC agreements in dealing with investment and services, but these provisions are limited in their effects because of the many restrictions on investment and services grandfathered in both countries. The proposed agreement involves a much more elaborate binding dispute settlement machinery than exists in the EFTA-EC agreements, but Canada and the United States have shied away from the types of supranational controls on subsidies that exist in the European Community.

Entering into a free trade area agreement is not a unique experience. Indeed, only Canada and Japan among the 24 members of the Organization for Economic Cooperation and Development do not belong to regional trading arrangements. But the Canada-U.S. Free Trade Area which could emerge by the end of the century undoubtedly will be shaped by the unique pressures impinging on the world's largest commercial relationship. Canada and the United States are engaged in a process intended to achieve more open trade which will be shaped to conform to the economic and political realities that are unique to North America.

Ambassador Reisman admonished us this morning not to engage in predictions about the future. I would like to peer into a crystal ball, however, and suggest that the spirit and substance of the Canada-U.S. free trade arrangement that could emerge is likely to remain much closer to the pragmatic approach of EFTA. Not only will Canada and the United States retain independent commercial policies for trade with third countries, but I doubt they will aspire to the more grandiose supranational machinery of the European Community. The Canada-U.S. Free Trade Agreement represents an attempt to manage conflict and resolve disputes arising from the exercise of national sovereignty by two highly interdependent and asymmetric economies while retaining the greatest possible degree of policy independence for both partners.

Notes

1. See Murray G. Smith "Commercial Policy" in R.G. Lipsey and M.G. Smith (eds.) *Policy Harmonization in Canadian-American Free Trade Area* (Toronto: C.D. Howe Institute, 1986).
2. See Victoria Curzon Price, *The Essentials of Economic Integration: Lessons of the EFTA Experience* (Basingstoke: Macmillan, 1974) and *Free Trade Areas, the European Experience* (Toronto, C.D. Howe Institute, 1987).
3. See Murray G. Smith "A Canadian Perspective" in *Perspectives on a U.S.-Canadian Free Trade Agreement*, (eds.) R.M. Stern, P.H. Tresize and J. Whalley (Washington: Brookings Institution and Institute for Research on Public Policy, 1987), pp. 54-59.

The Automotive Sector In The U.S.-Canadian Free Trade Agreement

Paul Wonnacott

The two principal objectives of the recently negotiated free trade agreement were to make trade relations between the two nations more open, and more stable, predictable, and secure.

The automotive provisions in the agreement address these two issues in an imaginative and constructive way. The results are about as good as might reasonably be hoped for, given the complexities and subtleties of the industry and of the existing arrangements under the Auto Pact of 1965.

The agreement makes trade more open by a phased elimination of remaining tariffs, including those on replacement parts and by bringing an end to the Canadian embargo on used cars within five years.

However, as most automotive trade has been duty-free since the Auto Pact of 1965, by far the more important objective is the second one — a more secure and predictable trading relationship. This is a particularly significant issue, since changes in the auto industry have raised questions regarding the stability of the Pact. The major assumption behind the Pact — that the U.S. auto industry would continue its world predominance — is clearly no longer the case. The rise of overseas challengers, and the responses of the two North American nations, have added to strains on the existing relationship. Specifically, the sources of strain have been, first, a long-lasting disagreement over the Canadians safeguards, and, second, competition for overseas plants. This includes incentives provided in both countries aimed at attracting new plants, a Canadian duty remission program based on export performance, and the U.S. foreign trade zones.

In addition, the Canadian automotive industry has been vigorously insisting that the Auto Pact safeguards be extended to overseas competitors; overseas firms should be required to meet Canadian production targets if they are to sell in Canada. A set of agreements that the Government of Canada has entered into with overseas producers, providing production-based duty remissions, may be interpreted as a way to phase in production targets during the 1990s. I will argue that if Canada had made Auto Pact safeguards compulsory for overseas auto firms selling in Canada, additional severe strains would have been created on the Auto Pact.

The free trade agreement substantially diffuses these strains. First, it ends the Canadian move toward compulsory compliance with Auto Pact safeguards by overseas firms selling in Canada. Overseas firms will not be required to meet the assembly and Canadian value-added requirements associated with the Pact. Indeed, the agreement goes further, to exclude them from the advantages of the Pact, which had previously been held out to them as an incentive if they voluntarily met the assembly and value-added standards. Furthermore, the production-based duty remissions — an intermediate step toward compulsory compliance with the safeguards — will be terminated by 1996, after the present agreements run out. Second, the Canadian export-based duty remissions are to be eliminated when the agreement comes into effect. And third, problems with the U.S. foreign trade zones are dealt with as part of the general drawback issue. The agreement provides an end to duty drawbacks within a five-year period. This is the simplest way to deal with the distortions that drawbacks could cause as duties are eliminated within a free trade area. Drawbacks on internal trade were similarly eliminated by the European Free Trade Association.

The Canadian elimination of export-based duty remissions is particularly desirable. Such remissions fall clearly into the category of export subsidy. Furthermore, from a U.S. viewpoint, current remissions are much more objectionable than the duty remissions of 1962-63, which led to a countervailing duty suit by a U.S. radiator producer and precipitated the negotiations that resulted in the Auto Pact. Although both sets of duty remissions — in the early 1960s and the 1980s — were formally non-discriminatory among nations, their effects were quite different. In the earlier remissions, Canadian firms earned the right to import more duty-free from the United States as a reward for exporting more to the United States. Incentives to export more to the United States were associated mainly with additional duty-free imports from the United States.

However, the major effect of the recent program is to allow more duty-free imports into Canada from Japan, as a reward for exporting more to the United States — exports that are duty-free under the Auto Pact. Thus, the duty-remission program of the 1980s is seen in the United States as a way of sucking imports in from Japan, and pushing exports to the United States. This program could have led to difficult countervailing duty actions in the United States within the next few years. It is in the interest of both countries to have this mischievous program terminated. For Canada, any short-term gains were offset by the danger of instability in U.S.-Canadian auto trade in the future.

Much more complex is the decision to restrict Auto Pact membership in Canada to the present participants. I will return to this in a moment. Two preliminary points should be dealt with. First, what has not been cleared up, namely, the question of grants or subsidies to auto firms. Of course, this is an issue that goes far beyond the auto sector. Perhaps the greatest single shortcoming of the agreement is that the most difficult issue of all — the definition of subsidies and the application of countervailing duty — was marked by an incomplete agreement, with a commitment to find a more comprehensive understanding in the next five to seven years.

Second is the issue so important in Canada: Was the Auto Pact preserved? The answer depends on what one considered the central features of the Pact. One — bilateral duty-free access. This has clearly been maintained and extended. It is more secure, because the danger of countervailing duties will be reduced with the elimination of the duty remissions. Two — Canadian safeguards for present firms. These have been maintained, although it is possible to argue that they were either strengthened or weakened. They were strengthened, in that the United States has at least tacitly accepted their legitimacy. They were weakened, because of the elimination of one of the major incentives to comply — the Canadian tariff on U.S. automotive products. However, the Big Three still have a very strong incentive to comply, and will almost certainly do so. They import about CDN \$3 billion from overseas sources into Canada each year. Consequently, they will have to pay approximately CDN \$300 million annually in duties on such imports if they fail to meet the Auto Pact standards. (Chrysler, which previously was in the weakest position to comply with the safeguards, has much more elbow room with the recent acquisition of American Motors and its up-to-date Canadian facilities.) Three — The multilateral nature of the Pact, from the Canadian viewpoint. This has been partially retained, for present

members. But the door has been closed to additional participants. On two of the three main issues, the Pact has been preserved. On the third, the answer is ambiguous. It has been preserved for present members, but not for future additions. In my opinion, forced membership might have raised a major problem, since its effects are quite close to duty remissions. Specifically, Japanese and other overseas firms would have gained the right to duty-free imports into Canada as a reward for exports to the U.S. (This still happens to some degree with the Big Three, but, politically, this is much less explosive in the United States.)

From the U.S. side, the question arises: Was a mistake made in tacitly recognizing safeguards? Probably not: safeguards are inextricably intertwined with multilateral duty-free entry into Canada. If safeguards had been ruled out, Canada would have faced a choice. Would it have "bilateralized" the Pact, confining duty-free entry to products originating in the United States (just as the United States confines duty-free entry to products originating in Canada)? Or would Canada have kept the multilateral aspects of its auto policy? Specifically, would it have allowed unlimited duty-free imports from overseas as well as the United States?

The obvious choice would have been a bilateralization of the Pact. This would have meant no more duty-free imports from overseas. This would have adversely affected the subsidiaries of U.S. firms in Canada — a penalty of CDN \$300 million in extra duties.

However, we can't speak of "the" U.S. interest, since U.S. parts producers see the Canadian safeguards and the residual multilateralism of the Auto Pact in quite a different light. They are upset because the residual multilateralism provides duty-free parts competition from overseas. In a news release on October 8, 1987, Julian Morris, President of the Automotive Parts and Accessories Association, argued that the U.S.-Canada free trade accord is "unfair". Specifically, he said, it "fails to eliminate Canadian protection of its auto/auto parts sectors. It would subject one-third of bilateral trade to a pro-Canadian managed — not free — trade regime".

My overall conclusion, nevertheless, is that the automotive clauses in the agreement were about as good as could be expected. The negotiators picked their way through a complex set of issues. They eliminated export-based duty remissions. They partially bilateralized the Auto Pact from the Canadian side, by limiting its privileges to present members. The results are a bit untidy, but I find it very difficult to imagine a substantially better outcome, under the circumstances.

Finally, I would like to touch on a question raised by Richard Lipsey this morning. What would the consequences be if the agreement were rejected? The overall consequences go far beyond my topic; I was asked to concentrate on the auto industry. For this industry, the rejection of the agreement would leave unfinished business on the table. The pre-existing situation is quite unstable, particularly with the Canadian duty remission programs. There would be two possible outcomes. Specific negotiations could be undertaken to deal with the outstanding problems. In this case, something like the auto clauses of the agreement would represent about as good an outcome as I can envisage. The other alternative would be to do nothing. But this would risk a major confrontation within the next few years over Canadian subsidies on automotive exports to the United States. We can address our auto problems now, or we can address them later, when they have become much more intractable.

The names of the two negotiators, and the chaotic last minute negotiations leading to the free trade agreement, act as a reminder of a child's game: Simon Says. And what does Simon say?

Simon says: It's over.

Simon says: It's not over 'til it's over.

Simon says: Murphy's wrong. Murphy's law no longer holds. Not everything that can go wrong necessarily does go wrong.

Simon says: It's a miracle.

Well, perhaps not a miracle. But it is a good agreement nonetheless.

The Outcome For Agriculture And Some Issues In Implementation

Bill Miner

Those of you who know me will recognize that it is a bit of a change for me to watch an agricultural trade negotiation from a distance and to read the results in the newspapers. But I am more than happy to have the opportunity to share with you my understanding of the results and some of the issues that will need to be faced in the period of implementation. I am glad to note from the list of people here that not all of you are growers of grapes or processors of wine. It might make the question period rather difficult for me.

In any event, in looking at the results, the trade agreement includes a number of significant changes that will affect most of Canadian agriculture. But not surprisingly, it stops well short of creating a complete free trade situation in this sector. Murray Smith has noted that this result is quite consistent with past free trade negotiation experiences. The principal difficulties for agricultural trade are global, and the solutions are being pursued multilaterally in the Uruguay Round. Still, the removal of tariffs on cross-border trade in agricultural products is, indeed, a major accomplishment. Also, in the important red meat sector and the closely related area of feed grains, the continental market is extremely important and the results here, and for other grains and oilseeds, are significant for Canada.

In addition, the bilateral trade in horticultural products is important to both countries, and the results are also significant, particularly for the United States. Exports of many processed agricultural products from Canada to the United States have been increasing in recent years, and the reduction in tariffs will help to enlarge this trade. These processed exports must continue to expand if Canadian agriculture is to succeed in attaining the generally accepted goal of adding value to our output. The agreement should

provide new opportunities for Canadian food processors, even though it will require adjustments in that sector to a much more competitive environment.

Obviously, neither country was prepared to negotiate major changes in the sensitive sectors of dairy, poultry and sugar. Nor were they prepared to alter their domestic agricultural support policies in a bilateral context. So only modest changes were made in these regimes.

Security of access to the U.S. market was an important Canadian objective for agriculture and, as you know, the agreement provides for a bilateral panel with binding powers that can pass judgment on the application of anti-dumping and countervailing laws. This is an important feature of the agreement. It has probably surprised some observers that a binding mechanism was the result. It will reduce uncertainty and should limit unjustified measures to restrict imports.

But it is disappointing that the United States was unwilling to address, in a bilateral context, the central issue of agricultural subsidies, their effects on trade and the use of countervailing measures in that regard. However, the two governments have agreed to work toward establishing a new system to address the problem of subsidizing and of dumping, to come into effect no later than the end of the seventh year. Meanwhile, they have agreed not to provide direct export subsidies on agricultural exports to each other's markets.

They have also agreed to consult more closely on the subsidizing of exports and to take account of each other's interests when using export subsidies to increase their sales to third markets. This has already become a contentious issue and I am not going to wander into that area except to observe that the agreement isn't in place at this stage and that this type of agreement, or commitment, must grow or mature. In other words, it must develop on the basis of confidence in the type of consultations that are occurring and the results achieved from both countries' points of view.

Only time will tell how useful those consultations will be to Canadian agriculture. Some of you may recall that, back in the 1950s and 1960s, there was indeed a bilateral sub-committee that sought to deal with issues of the nature that we are seeing today in the grains industry. These issues emerged from the use of somewhat different export instruments, but the effects were similar. And at that time I think that the consultative process was seen to be of significant benefit, certainly from a Canadian perspective.

Turning to the implementation of the agreement; the elimination of tariffs in the agricultural sector will, with a few exceptions such as live cattle and alfalfa pellets, take place over a one-year timeframe. To

respond to the seasonal problems encountered by the Canadian horticultural industry as a result of the earlier U.S. harvest, and to provide a greater opportunity to adjust, Canada may temporarily restore its present MFN tariffs on fresh fruits and vegetables, over a 20-year period. This provision may be used in depressed price conditions, provided the Canadian basic acreage is not expanding. That is a realistic provision, I think, in the sense that the industry presumably would not be expanding its productive acreage in circumstances of increased and severe competition. Canada is competitive with some fruits and vegetables, but I expect that the Canadian industry will resort to this extended protection for a number of crops.

The agreement will exempt each country from restrictions under their respective meat import laws. This will be welcomed by the Canadian beef industry. However, issues of potential displacement are likely to arise if the restrictions are triggered against Third World imports by one country and not by the other. There will, no doubt, be consultations in the future should that occur.

The prohibition on export subsidies on bilateral agricultural trade is an important precedent that one hopes will spread to the multi-lateral trade area. Canada will face elimination of rail subsidies on export of grains and products to the U.S. through ports on the West Coast. These subsidies to the United States are of recent origin, and they were not permitted under the previous Crow Rate. In my view, it was inevitable that this feature of the Western Grain Transportation Act would be challenged and would have to be changed at some point.

The U.S. agreement to exempt Canada from any future quantitative import restrictions on products containing 10 per cent or less of sweeteners should be helpful to Canadian producers of these products. Canada's agreement to eliminate import licences for wheat, barley and oats and their products when producers' subsidy levels or support levels become equivalent is also a significant change. Here the approach will be based, I understand, on the use of a concept of producer subsidy equivalents as a means to examine income transfers to various producers — of grain in this case. I understand as well that the calculations — and some considerable work has been done in this area — would show that support levels are about in balance with respect to feed grains. Both countries agreed not to re-introduce grain import restrictions as long as there are no significant changes in support programs that would have an important effect on imports. The key impact of this commitment relates to the U.S. Section 22 quota restrictions. They have been suspended but, nonetheless, they could have been applied if the U.S. wished to do so.

U.S. domestic prices for most grains are currently considerably above world levels. This is due, of course, to the use of substantial export subsidies. As a result, the U.S. market is attractive to Canadian shippers. Canada's quality control on import of U.S. grain will be maintained to avoid mixing varieties and to protect our reputation as a supplier of quality grain. For wheat, it is intended that these controls would be exercised through an end-use certification system, and this would probably be operated by the Canadian Grain Commission.

The changes should encourage more competitive pricing of grain inputs to the cereal processing industry in Canada and have some beneficial effect on that industry. At the same time, because of the agreement, the government will have to review its two-price system for milling wheat.

There were no changes with respect to the dairy sector, except for tariffs. Nothing in the agreement prevents the continuation of Canada's system of marketing boards which, of course, relates to the use of new quotas that must be consistent with the GATT requirements. However, Canada has agreed to increase the global quotas on poultry and eggs on a one-time basis to reflect the recent levels of imports. The increases that occur are modest. For chickens, for example, the amount will be approximately 1.2 per cent of domestic production. Although this result will not be welcomed by the poultry industry, it may help to moderate the costs of production quotas and encourage consumption modestly. On the other hand, some envisage an increase in imports of U.S. poultry products as tariffs are reduced.

The agreement to reduce trade barriers resulting from technical regulations is an important forward step. In fact, this is probably more important than most would anticipate, given our extended border and the wide range of products crossing it. It should reduce unnecessary inspection delays, which have been a problem for Canadian meat exporters, for example. And efforts that have been under way to harmonize technical regulations should, in fact, be stimulated by this agreement.

Both sides have agreed to end discriminatory distribution listing and mark-up practices for wine and distilled spirits. This will involve changes in the practices of provincial liquor boards. These provisions will be implemented immediately for spirits and over a seven-year period for wines. Canadian producers will face adjustments, as you are aware from the press, as a result of these changes, but there may be some opportunity for increased export. You don't hear about that in the press. Products of the brewing industry are not covered in this way. I might note that the United States is not the main competition in this sector. It is coming largely from Europe.

The results of the bilateral trade negotiations for agriculture are relatively modest. But they are impressive, given the serious difficulties confronting this sector and the state of near warfare in world markets. The two governments have agreed to work together in the Uruguay Round to improve and enhance trade in agriculture. Indeed this week in Geneva, Canada tabled a proposal calling for basic reform of world agricultural policies. Specifically, Canada proposed the adoption of a comprehensive approach of eliminating all subsidies that distort trade as well as all access barriers over a period to be negotiated. The Cairns Group countries are presenting a common proposal to achieve similar objectives. Results of the Canada-U.S. Free Trade Agreement for agriculture could be strengthened and broadened by a comprehensive move to liberalize trade on a multilateral basis. I guess the last comment I should make in regard to the multilateral negotiations is that we must recall that both parties retain their GATT rights on those issues not covered by the bilateral agreement.

Discussion

Gordon Robertson

Question:

My question is with respect to the energy section of the agreement. Do I take it that your interpretation is that the agreement will not affect provincial government rights in the areas of export policies and pricing policies? As you know, Alberta and other provinces have explicit export regulation procedures and also border pricing processes which they apply. It would seem to me that this would perhaps be a point of contention with the Americans in the spirit of the energy pricing agreement. I wonder if you see those provincial rights being somehow excluded from the spirit of this agreement?

Murray Smith:

Well, I may not be the best person to answer every aspect of your question. As I understand it, the agreement certainly intends to reach government policies that act as export taxes or import duties and create discriminatory pricing provisions. I do not see anything in the agreement that would impinge on the capability of the Government of Alberta, or the Texas Railway Commission, for that matter, to regulate resource development. If a province or state were to proclaim that the rate of extraction from the resource has to be slower or faster over some period, that would be unlikely to raise significant problems. But if Alberta were to decide to impose an export tax, that

would raise some interesting questions, both in terms of this agreement and with respect to the constitutionality of that arrangement under the Canadian Constitution. I am not competent to comment on the constitutional question — others might be — but as I understand the agreement, it is focusing on the pricing provision and not on the ability of jurisdictions to manage the rate of extraction.

Debra Steger:

With respect to the constitutional question, the provinces do not now have the power to impose an export tax or to restrict exports, because that is explicitly a federal power. They can issue removal permits that affect what moves out of the province to other Canadian provinces or, in fact, internationally, but that is all they can do. They cannot impose an export tax. It is not within their jurisdiction to do that. We have a couple of famous Supreme Court cases in which the Saskatchewan government attempted such measures.

On the volume side provinces can — and do — explicitly design surplus procedures. The elements document suggests that the surplus tests should be restricted to a monitoring function, but the wording is very vague and ambiguous at this point. I believe that wording refers to the powers of the National Energy Board and not necessarily to provincial authorities, but Ambassador Reisman is probably the person to whom you should be addressing your question.

Gordon Robertson:

It appears Ambassador Reisman is tied up in the corner, so we will move on.

Jean-Luc Pepin:

It is rather amusing, historically speaking, to realize that when I was fighting for the transformation of the Crow's Nest rate, little did I know that I was working for Simon Reisman. From what I have read, these advantages on the export of grain will come only when there is an equivalent degree of subsidization on both sides. I believe Mr. Miner said that this had been reached for feed grain. My question is, how much do we export in grain to the United States now and how much would we reasonably stand to export when the agreement becomes a reality?

Bill Miner:

I used to work fairly closely with Mr. Pepin and I can always rely on him to ask difficult questions. The question of equivalency in support measures relates to the removal of licensing for the Wheat Board grains only. In that regard, what I indicated was that there would be a technical calculation done of the income transfer effects of total policies, called a "producer subsidy equivalent". At least, it would be based on that to give a relative measure of the degree of subsidization on either side. As I understand it, that calculation shows a close balance for the feed grains, but not for wheat. Wheat is considerably out of line; the U.S. support levels are considerably higher.

The question of how much we now sell and how much we could sell could be much better answered by someone else in the audience. My own view of where we are in terms of sales is that they have, in fact, been increasing. Part of this would relate, of course, to the fact that the United States tends to have a two-price system because of their export subsidies, so there is a premium in the United States in relation to the world market. I believe that this premium has shown up particularly for wheat, but perhaps for some other grains too. And, indeed, our sales to the United States have been increasing in recent years, particularly last year. I wouldn't like to put a figure on it — I believe it is less than 1 million tonnes and more than ½ million tonnes. But perhaps I am in the right ball park when I say that. How much more? I couldn't really answer that because it would be fully speculative on my part.

I believe that the Wheat Board can operate with more confidence in the U.S. market as a result of this agreement, because the United States cannot trigger its Section 22 quotas which I think, were the first line of concern in relation to selling to the United States. On the other hand, the countervail laws are not changed so that the subsidy question remains a question. I suppose that as long as we are clearly subsidizing less, there shouldn't be too much political panic if you sell down there, but you can never be sure. The United States could make a complaint and it would be judged on our level of subsidy only, as far as I understand the law.

Question:

The other day there was a meeting between our chief negotiator and a number of auto industry representatives. Out of that meeting, there was a statement by Frank Stronach from Magna and another company president who said that because of this agreement, they would have to shift investment and production to the United States. Now, I

am wondering if you know on what basis they are arriving at that sort of announcement? What would be the reason for a shift in investment and production to the United States?

Paul Wonnacott:

What happens if we don't get this agreement, if it doesn't go through? In my opinion, the Auto Pact is then in an unstable situation. We will be in a situation where Canada is moving toward a unilateral application of the White-Laval proposals — where Canada unilaterally has the duty remission program, which amounts to a subsidy, where Canada is planning by the early 1990s to have something like 350,000 to 400,000 East Asian automobiles including trucks produced in Canada. The United States figure is something like 1.7 million. You don't have to be a mathematical genius to figure out that Canada is planning to be a major exporter to the United States of those products.

Sometime between now and 1995, something is going to go wrong. My view would be that if the general free trade agreement doesn't go through, we will need to sit down quickly and, in fact, re-open or renegotiate the Auto Pact. The best outcome I could see, particularly for Canada, if that were to happen, is exactly what we have in the automotive sections of the present agreement. I don't understand why Bob White should be as unhappy as he is unless he thinks he can have a situation that the United States would accept indefinitely. That would run foul of the American law and it seems, from a political point of view, to be quite absurd.

Simon Reisman:

Yes, I was at a meeting last week with David Peterson. It was a meeting that was laid on at the last First Ministers' Conference where the Prime Minister volunteered me to go and talk to David Peterson and the industry and to explain to them what a wonderful thing we had done for them. Among those attending were Bob White, Roly Buck, and Frank Stronach. Also attending were the President of the Parts Makers' Association and the Chairman of the Board of the Parts Makers' Association, who had a resolution of the Board to speak for 350 part makers in Canada. The official spokesman for the parts makers thought we had a pretty good agreement. They would like a higher rule of origin — I can talk about that if people are interested

in the rule of origin — but they felt they were in a better position, not a worse position, to produce parts in Canada.

Look, it is plain and simple. I believe that Paul Wonnacott gave you a good review of this agreement in so far as it relates to the auto industry and the Auto Pact. I have no hesitation in saying that we have an Auto Pact-plus type of agreement. And the plus results from two things: one -we have a new rule of origin, which is much tighter than the Americans applied in the past. It applies the 50 per cent rule of origin to direct manufacturing costs. That's equivalent to something close to 70 per cent on their old calculation. It provides a whole new base of opportunity to bid and that, indeed, is the view of the Parts Makers' Association. The replacement parts people, who were not included in the Auto Pact in the past, are now very pleased that we have free entry into the United States. Indeed they urged us to put the tariff changes in on a five-year rather than a 10-year basis. So the official spokesmen for the two large parts making associations, both original equipment and replacement parts, think that we have a pretty good thing going here. Of course, they would like a higher rule of origin.

That meeting was a an "Auto Pact" meeting; it was designed to achieve a particular purpose. I don't recall that the statements they made afterwards actually said that they would move out if the free trade agreement came into place.

Roly Buck is a particularly interesting fellow because he was around at the time we negotiated the Auto Pact. I remember very distinctly Roly Buck coming to me when I was the Deputy Minister of Industry and the chief negotiator for the Auto Pact. He wept in my office and said he was a very small parts operator operating in a very limited operation. He now has a multi, multi, multi-million dollar operation, all derived from the Pact. He's saying exactly the same today as he said in 1964, and I don't know what it would take to satisfy him, but he is only one of about 350.

It was a very strange meeting. It was designed to achieve a particular end. Bob White had the run of it and most of the time I thought he was speaking as a Vice President of the NDP and not as the head of the auto union. Now that is a pretty straightforward comment but I stand by that.

Gordon Robertson:

Well, if there are no more questions, perhaps we could move on to the second part of our afternoon program. The first speaker dealing with the dispute settlement issues is Debra Steger.



Analysis of the Dispute Settlement Provisions: A Canadian Perspective

Debra Steger

The proposed Canada-United States Free Trade Agreement is a historical and monumental achievement in Canada-U.S. trade relations. Two fundamentally important things have been accomplished in this agreement.

The first major accomplishment of the Free Trade Agreement is that it will establish a unique and comprehensive set of rules to govern the Canada-U.S. trading relationship in future. The current system consists primarily of the General Agreement on Tariffs and Trade (the "GATT") and domestic Canadian and U.S. law which implements the GATT agreements. The dispute settlement provisions of the Free Trade Agreement represent an important break with the dangerous pattern of unilateralism that has increasingly determined trade disputes between Canada and the United States.

The second important accomplishment is the establishment of an institutional framework for the avoidance and resolution of trade disputes. The Free Trade Agreement is an evolutionary document and it creates an evolutionary process. Some of the important rules will be developed in future and some of the rules that have been negotiated will have to be changed over time as economic conditions change.

The establishment of the institutional framework is critical to the successful operation and further development of the agreement. Both Canada and the United States have been very apprehensive about ceding sovereignty or decision-making power to a supranational body. As a result, the dispute settlement mechanisms established under this agreement are less formalistic and structured than the institutions established under the European Economic Community Treaty. The EEC, it must be remembered, is a common market which has as its principal objective political, as well as eco-

nomic, integration. The Canada-U.S. Agreement is a free trade area agreement, the least-integrative form of economic relationship permitted under Article XXIV of the GATT.

Constitutional questions have been raised concerning the proposed dispute settlement process in both Canada and the United States. Gary Horlick might touch briefly on these issues from the U.S. perspective. I agree with the Honourable Donald Macdonald that replacing judicial review with a bi-national panel procedure will not create a major problem in Canadian law. Since the right to judicial review of determinations by the Canadian Import Tribunal was created by statute, the Federal Court Act, the ability of Parliament to alter the review process is not affected by section 96 of the Constitution Act, 1867.

A lot of attention has been paid in the press and public commentary to the bi-national panel procedures which will be established for reviewing final countervailing and anti-dumping determinations. But very little attention has been paid to the general dispute settlement provisions of the Free Trade Agreement. The Honourable Donald Macdonald gave you a good explanation of those provisions today, but I believe that there has not been enough emphasis on how these mechanisms could work in future to avoid and resolve some of our trade disputes.

Under the general dispute settlement provisions, the Canada/U.S. Trade Commission will be established. There are notification requirements and formal channels for government-to-government consultations. Where a matter evolves into a dispute, the Commission has a wide range of mechanisms it can use to resolve a dispute: it can establish an investigating committee, appoint a mediator or an arbitrator, or refer the matter to a panel of experts. In some cases, it may refer a matter to binding arbitration and in other cases it may use consensual decision-making procedures similar to those of the GATT. Although these general dispute settlement mechanisms are derived from the GATT panel procedures, they are an innovative, hybrid set of institutional provisions and are superior in many respects to the GATT system.

As a result of this Agreement, formal channels of intergovernmental communication between Canada and the United States will be established where there were none before. As well, a flexible set of mechanisms for resolving disputes will be created. The success of these dispute settlement mechanisms will ultimately depend on how frequently the notification and consultative mechanisms are used and with what effectiveness. It is very difficult to predict exactly how these mechanisms will work in practice. The effect, particularly of the bi-national panel mechanism for review of anti-dumping and

countervailing duty decisions, will depend very much on economic and social factors at work in the economy in general. Much is going to depend on what happens with the U.S. trade deficit, what happens in financial markets, whether U.S. protectionism continues to increase unabated, how many trade cases are initiated in the United States over the next few years, and whether or not the proposed U.S. Omnibus Trade Bill is enacted and applied to Canada.

These dispute settlement provisions of this Agreement are complex and varied. The agreement contemplates the establishment of a Canada-U.S. Trade Commission (the "Commission") to supervise the operation of the agreement, oversee its further elaboration and assist in the resolution of disputes.

Canada and the United States have agreed to develop and implement, within a period of five to seven years, a substitute system of anti-dumping and countervailing duty laws. They have agreed to establish a Working Group and use their best efforts to implement a new trade law system within that period. If such a system is not implemented within the agreed time, either country may terminate the Free Trade Agreement on six months' notice.

In the interim, both countries will continue to apply their own domestic anti-dumping and countervailing duty laws and they retain the authority to revise their domestic laws. However, a new legislative watchdog has been established under the agreement to ensure that domestic laws are not changed in ways that would hamper access to each other's market. First of all, neither country can change its existing laws without specifically naming the other country in the proposed legislation. This provision will have a deterrent effect on new legislative developments. Members of Congress are extremely reluctant to name a specific country that is the target of a particular measure. The other country must be notified and may request consultations when a new amendment is proposed. The proposed changes must be consistent with the GATT Anti-dumping Code and Subsidies Code and with the object and purpose of the Free Trade Agreement.

With respect to dispute settlement, one of the objects of the Free Trade Agreement is to establish fair and predictable conditions for progressive liberalization of trade while maintaining effective disciplines on unfair trade practices. Either member country may request that a panel be established to review proposed legislation to determine whether it is inconsistent with the GATT and with the Free Trade Agreement. A panel will issue a declaratory opinion and may recommend changes to proposed legislation. Where it determines that modifications are necessary, compulsory government-to-

government consultations are triggered for 90 days. If the country that is proposing the legislation does not comply with the panel's decision, and no other mutually-satisfactory solution is found within nine months, the other country may impose mirror legislation or, alternatively, terminate the agreement within 60 days.

The bi-national panel review procedure for anti-dumping and countervailing duty investigations has received most of the attention in the press. The purpose of this bi-national panel procedure, as stated in the Preliminary Transcript, is to replace judicial review of final anti-dumping or countervailing duty orders of the Department of Commerce ("DOC") or the International Trade Commission ("ITC") in the United States, or the Department of Revenue or the Canadian Import Tribunal in Canada. There is some uncertainty in the Preliminary Transcript as to whether the words, "replace judicial review", mean replace all elements of judicial review or just some elements. The Deputy Minister of Justice for Canada gave a speech recently in which he said that either country will have the opportunity after a preliminary determination is made to file a notice that they are going to seek bi-national review of a final determination. If either member country does not file notice, then the private parties engaged in the action would have the opportunity to use the normal judicial review procedures under domestic law. In other words, private parties could seek judicial review in the courts if their government decided not to seek bi-national review in a particular case.

An important aspect of this bi-national panel review procedure is that it is government-initiated. It is a government-initiated procedure in a system that is really a private party system. Countervailing duty and anti-dumping complaints in both Canada and the United States are made by private firms against foreign exporters. A mechanism will have to be devised in Canada to enable the private parties engaged in these disputes to cause their government to act on their behalf. Implementing legislation will have to be developed which would create something like the Section 301 procedures in the United States whereby private parties can initiate a complaint and cause an investigation to be commenced which might lead to their government initiating formal proceedings under the bi-national mechanisms of the agreement.

There are several other important questions that remain to be resolved about how the bi-national panels will operate. What is the administrative record that a panel is to consider in conducting its review? Will the panels be able to review new evidence, or will the onus be on the private parties to ensure during the course of an investigation that every scrap of relevant evidence is "on the record"?

Will the strict standards of judicial review in either country be applied by the panels? Will the panel decisions be narrow and legalistic or broad and policy-oriented? Much about the panels' decisions will depend on who is appointed to the roster of panelists. Will it be judges? Will it be legal scholars? Will it be trade negotiators? Will it be former politicians? If we have judges or legal scholars, I think we will have strict, legalistic decisions. If we have trade negotiators or economists, they will not assiduously apply strict principles of judicial review to their determinations and their decisions will presumably be more policy-oriented.

Another question that one might ask about this process is: what will be the precedential value of the decisions made by the panels? We know that a panel decision is binding on an investigating agency in a particular case where an issue is remanded back to it. In other words, a panel has the authority to either overturn a decision of an investigating agency, or to remand it back to the investigating agency for a rehearing. In the latter case, the panel would presumably give the agency explicit directions as to how the law should have been applied. However, what is unclear is whether a panel's decisions will be binding on the investigating agencies in future cases, that is, whether they will become legal precedent in U.S. or Canadian law.

Bi-national panels will be authorized to review agency decisions in light of whether or not they comply with domestic law. There is to be no direct resort to the GATT Anti-dumping Code or Subsidies Code in a review of a final anti-dumping or countervailing duty decision. I believe that it would have been desirable if the panels would have had the power not only to look at domestic law but also to look at the GATT Codes directly. However, it must be remembered that the bi-national review procedures are interim measures designed to preserve and maintain stability until a new system of trade laws is implemented.

This bi-national panel review procedure will be very helpful in complex trade cases involving large volume of trade where there are arguable questions of law and the investigating agencies appeared to lack objectivity in their decision-making. For instance, in *Softwood Lumber* there were a number of arguable questions of law that one could have raised on judicial review, including the definition of subsidy, the double counting practices in calculating the subsidy, and other substantive issues. A major advantage of the bi-national review process is that it will operate much faster than existing judicial review. A panel will issue a binding decision in 300-315 days rather than the two to four years that it currently takes for all legal remedies to be exhausted in the courts.

Also, the existence of the bi-national panel procedure may have a sobering effect, it may increase objectivity and encourage careful decision making by investigating agencies. Unlike some Canadian commentators, I do not believe that the primary problem with the U.S. trade laws has been lack of objectivity or politicized decision making on the part of the Department of Commerce or the International Trade Commission. The problem is the rules themselves, the existing trade laws. The current rules in the United States and in Canada, while technically GATT consistent, are anti-competitive and flawed in many respects.

I regret that Canada and the United States were not able to abolish the anti-dumping laws as a result of this agreement. The anti-dumping laws should be replaced by competition laws governing anti-competitive pricing practices. There are other provisions in the anti-dumping and countervailing duty laws that, in themselves, create decisions which have trade distorting effects. Some of these include the "sales below cost" provisions of the anti-dumping laws, the cumulation provisions, and the standing provisions. If we eliminated the sales below cost provisions and the current standing rules, the U.S. anti-dumping investigation involving Canadian potash would not have been initiated. The injury and causation tests also need to be made stricter in both countervailing duty and anti-dumping investigations.

The key accomplishment of the Free Trade Agreement in the dispute settlement is the commitment on the part of both countries to develop a new trade law system within five to seven years. We have a five to seven year window in which to develop a substitute system of trade laws for North America. No one should underestimate the importance of developing these new rules. They are extremely important. Without reform, in my view, we cannot be assured that Canadian industries will not be subjected to harmful trade cases in the future. It is absolutely imperative, in my view, that a Working Group be established soon to begin this very difficult but important work. An encouraging note is that in the Uruguay Round of multi-lateral trade negotiations these same issues will be discussed in the next three or four years. The key issues in that Round are subsidies, agriculture, and trade in services, all areas which have been left for further elaboration in the Canada-U.S. Free Trade Agreement.

The institutional provisions, or the general dispute settlement provisions, of this agreement are also very important but they have been ignored. The Honourable Donald Macdonald has already outlined these general mechanisms for you, but I will try to add how I think they may be used.

The agreement proposes a very flexible general dispute settlement mechanism. It is modelled on the GATT and the Tokyo Round Codes, but it is superior to the GATT system. There are notification requirements, formal channels for consultations, and a range of mechanisms for resolving disputes. The Commission may appoint a special committee or Working Group, call on technical advisors, appoint a mediator or arbitrator, or establish a panel of experts to consider the matter. In some cases, the decision of such a panel will be binding.

The general dispute settlement provisions really have very broad application. These provisions apply to the avoidance or settlement of all disputes respecting the interpretation or application of the agreement. There are opportunities for creative use of the general dispute settlement provisions, I would suggest, even in trade cases involving the anti-dumping or countervailing duty laws. The dispute settlement provisions will apply whenever a dispute arises concerning the interpretation or application of the agreement or whenever a member country considers that an actual or proposed measure of the other country, or its political subdivisions, is or would be inconsistent with the obligations of the agreement. That is GATT Article XXIII language. The general dispute settlement procedures may be used not only in a case involving a technical violation of the agreement, but also where a government practice or measure, or a decision of an investigating authority or a court, has been made that is inconsistent with the purpose and objectives of the Agreement. This provides, in my view, a member government with an extremely wide latitude to request consultations or to apply to the Canada-U.S. Trade Commission for resolution of a particular dispute.

The time limits established in the institutional provisions for every stage of the dispute resolution process are extremely important. These time limits will ensure that disputes are dealt with expeditiously and efficiently with as little cost as possible to private parties or industries. As the general dispute settlement procedures are also government-to-government procedures, it is important that domestic legislation provide explicitly for mechanisms whereby private parties, and also the provinces and municipalities, can require the Government of Canada to take action on their behalf. Without such procedures, the effectiveness of these mechanisms will be limited. One advantage of a government-initiated system is that it will be administered at no direct cost to the private parties involved. It will thus be faster and cheaper than the current system.

The dispute settlement provisions of the Canada-U.S. Free Trade Agreement are superior to those of other free trade area agreements or the GATT in several respects. First, the Canada-U.S. agreement contemplates the establishment of a permanent Canada-U.S. Trade

Commission (the "Commission") to supervise the operation of the FTA, oversee its further elaboration and resolve disputes. Second, there are explicit time limits established for every stage of the dispute resolution process which will ensure that matters are dealt with in an expeditious and efficient manner. After a mandatory period of consultations, either country may refer a matter to the Commission, and the Commission is required to convene within 10 days to endeavour to resolve the dispute. This is superior to the GATT or European Free Trade Association ("EFTA") mechanisms where there are many opportunities for lengthy delays. Other free trade area agreements such as Australia-New Zealand or the bilateral free trade agreements between the European Community and the EFTA countries do not provide for such formal and binding dispute settlement processes.

For a small country, such as Canada, engaged in a major trading relationship with a much larger world power, there are significant benefits to basing that relationship on a system of rules and a formal impartial dispute settlement process.¹ The major achievement of the proposed Canada-U.S. Free Trade Agreement is that it establishes a unique and comprehensive system of rules to govern the Canada-U.S. trading relationship in future. The rules, like the relationship, are not static. The Canada-U.S. Free Trade Agreement provides a framework for further elaboration of the rules as required and mandates the development of new rules in certain key areas, such as the anti-dumping and countervailing duty laws.

Whether or not these dispute settlement procedures will work effectively to ensure access to either country's market for our industries, depends ultimately on the goodwill of both member governments. The success of this agreement depends, first of all, on the good will of the Government of the United States to ensure that until the agreement comes into effect, any anti-dumping or countervailing duty determinations will not be allowed to destroy the objects or purposes of the agreement. Also, it will require continuing good will on the part of the investigating authorities, the Department of Commerce, the International Trade Commission, the Department of Revenue and the Canadian Import Tribunal, after the agreement has been implemented to ensure that their determinations are in accord with the general spirit and objectives of the agreement. Most importantly, good will is required on both sides to ensure that the substitute trade law system is, in fact, implemented within the agreed time frame.

1. John H. Jackson, "Governmental Disputes in International Trade Relations: A Proposal in the Context of GATT" 13 *Journal of World Trade Law* 1, (1979).

Analysis of the Dispute Settlement Provisions: A U.S. Perspective

Gary Horlick

Debra Steger has very ably described the dispute resolution mechanisms and taken away everything I was going to say, thus relegating me to the role of commenting.

I will focus on the anti-dumping and countervailing duty dispute resolution mechanism. In one sense, it is not a very important part of the agreement. Most business transactions between the United States and Canada never get involved in this area, and the other parts of the agreement are far more important in economic terms. I would suggest to governments, and especially to businessmen, to focus on the rest of the agreement. However, in my view, anti-dumping and countervailing duty dispute resolution has become very important in these negotiations for two reasons.

First, disputes attract the attention of media and politicians. As we all know, if someone goes out every day and does his job, it is never reported; if he goes out and kills someone, it's in the headlines. The media focus on the "ax murders", not the normal transactions.

Second, and probably more important: One important goal of these negotiations for both countries is to improve the predictability of handling what are, in essence, private disputes. Canada was more explicit about it, but this is a force in U.S. policy. These trade law disputes, anti-dumping and countervailing duties, are not really matters of high policy. They are attempts by businesses in one country to limit competition that happens as a result of imports. And, as Adam Smith observed over 200 years ago, if they could limit competition domestically, they'd do that too. Nothing has changed the validity of Smith's observation.

It is important to have predictability, not only for existing business, but also (and most important in terms of what both governments are looking at) for new investment.

Trade rules are rules about investment. What a business wants to know when it builds a new plant is what size plant to build, what size market it is going to have. And that requires a predictable, stable environment. Indeed, Rodney Grey's writings on contingency protection focus explicitly on this. It could be far better for business to have a stable 40 per cent tariff and no other threats of protection than to have an unpredictable contingent protection system.

For whatever reason, this dispute settlement mechanism on anti-dumping and countervailing duties became the keystone of these negotiations. The result was a unique — and really quite startling — binding, bi-national dispute resolution. There is nothing quite like it in the world — it will govern both cases and changes in law.

Ideally, in an agreement — and this was Canada's request as I understand it — there would be a binding dispute settlement mechanism applying a jointly agreed set of rules. It became impossible to negotiate an agreed set of rules. For example, the newspapers mentioned that one of the major sticking points was regional development subsidies. This is an appropriate example of my thesis that this is more important to media and politicians than to businesses. I checked every U.S. countervail case against Canada since 1980. In no case have these regional subsidies ever reached a 1 per cent countervail level. They get an enormous amount of attention, but they would not affect businesses. It is very important for politicians to cut ribbons — they have their own purposes for subsidies. The most notorious examples of regional development grants have usually been competition between localities in the United States and localities in Canada to take money from relatively poorer taxpayers and give it to relatively wealthier owners of corporations.

That said, there is a challenge in this agreement, as Debra said, to develop those new joint rules. That is extremely important. The essence of this agreement, if you think about it, is to try to create an economic unit that is more dynamic, creates more wealth, is better for all of us. Within that, you want to get rid of government barriers to improved efficiency. These trade rules, anti-dumping and countervailing duty rules, are no longer about fairness and trade; they are impediments to efficiency. Both countries would be better off getting rid of them.

One odd source of proof for this is a free trade area not known for its attachment to economic efficiency, the European Community. In the original treaty the EC phased out intra-EC dumping rules quite quickly and set up a central office that tries to limit subsidies on a fairly rational basis. It deals with over 100 cases a year and is active in clamping down on national governments. Obviously, that requires

the EC's supernational authority, which was impossible in the U.S.-Canada context. The EC was well aware that these trade laws are not good for business. They are bad for it and the EC got rid of them as fast as possible. I would emphasize the importance of fixing the dumping law especially. Although subsidies get all the newspaper ink, the dumping law is far more irrational. That margins on potash could range from 9 per cent to 85 per cent shows there is something wrong with the law. Some difference among companies could be expected, but that range of difference is remarkable.

I have been asked to comment on the U.S. constitutional law issue. There is a mini debate going on in very rarified constitutional law circles in the United States about a constitutional issue here. I want to clarify what that is. It is not about judicial review. In fact, it would be completely constitutional for Congress to abolish judicial review of dumping and countervailing duty cases. The proof of that is simple. Congress put judicial review into effect in 1979. Until then, there was no review to speak of. And there is no constitutional right to it. What Congress did in 1979, it can undo.

The constitutional issue has absolutely nothing to do with Canada, U.S.-Canada trade, or trade at all. It has to do with the relationship of independent agencies to the U.S. executive branch. There is a school of thought among some lawyers in the United States, in particular one office in the Justice Department, that no independent agency can tell the President what to do. Using that theory, they argue that this new tribunal can't tell the President what to do. Under the same theory, they would argue that the International Trade Commission is unconstitutional, as is the Federal Trade Commission, the Securities and Exchange Commission and a whole list of other agencies. Just reciting the list of agencies conveys the unlikelihood that they will all be abolished. But when you hear an argument coming out about constitutionality, that's the argument. It has nothing to do with U.S.-Canada trade.

There will be some repercussions because USTR presumably does not want to have to fight the fight if it doesn't have to. USTR will try to find some sort of compromise within the Administration. I would like to emphasize that whatever comes out on this issue will have no effect on the U.S. implementation of this agreement. Any American President will implement this agreement and the binding nature of it.

People always say, "What makes international agreements binding? There is no policeman". The best example I can give you is the GATT. Maybe with one exception in 40 years, the United States has never violated a GATT-bound duty. To say that Congress can simply

change everything next year in this agreement is just as true as if Congress decided to change GATT-bound duties by a $\frac{2}{3}$ override at a Presidential veto. It never has. You will be hearing about the constitutional issue occasionally, but it's not really about trade or about Canada. It has to do with fights between different factions of legal scholars and the administration.

Let me return to trade, U.S.-Canada trade and the dispute settlement mechanism. Why is this better than judicial review? I would like to repeat something Debra Steger said. The U.S. courts, and for that matter the administrative agencies, have not handled dumping and countervailing duty cases politically. I will drop a footnote to open up the possibility that the second lumber case was handled politically by the Department of Commerce. I am not going to say so definitively, but a lot of people think this is the case.*

Clearly, I would consider Lumber II a "one off". The other cases are not done politically. If you look at potash, for example, and go through it technically, there are issues in the preliminary determination where, had Commerce wanted to find higher margins, it could have. The dumping law doesn't make sense, but it was not a political fix; that's not the real problem. As I've said, the courts haven't been particularly political in their decisions. There are decisions by judges, the International Trade Commission and Commerce that were politically unpopular when they were made. The real problem is Lumber II, and the perception of possible unfairness by the administering agencies. This new tribunal helps wipe that perception out. That's important, because perceptions do matter.

This tribunal is not going to be biased in favour of one country or another. The structure prohibits it. That's important in terms of perception. Equally important — at least to me, as a practising lawyer, and to the exporter I represent — are some practical advantages that haven't been addressed. First, there are five judges, not one. Reviews, at least in the United States, go first to a single Court of International Trade judge. I cast no aspersion on the individual judges; it is becoming a good bench. Very simply (as is true of appeals courts that have multiple judge panels), there is a smoother result when there are five judges rather than one. There is more room for variation with one person than with five. No one focuses on that, but I assure you, to a practising lawyer, that's a true advantage.

*It is worth noting that Commerce, in essence, has disavowed that case in practice in every subsequent case. Four judges in the Court of International Trade have issued opinions that would not lead you to the Lumber II decision, and a recent informal paper from Commerce skirts it nicely.

The most important improvement here is speed. The panel must complete its deliberations and issue a decision within 300 days. In the United States, and I suspect it is true in Canada, there are no time limits put on the courts in civil matters. A normal judicial review of anti-dumping and countervailing case takes at least a year or two in the Court of International Trade and another year or two in the Court of Appeals for the Federal Circuit, the appellate court. Two to four years is a long time.

That time became a factor in the Lumber II case. If one of your options is to sue, but you know the U.S. government will appeal to the Court of Appeals, you know you're in for a four-year wait. "Justice delayed is justice denied." Do not under-emphasize the importance of the speed of the new procedure. It is very important in the big case, the "hot" case, that you have a meaningful answer in the 300 days.

One of the major U.S. complaints about GATT dispute resolution is that it takes too long. One of the controversial aspects of the omnibus trade bill is a Congressional provision that retaliation must occur, where cases have been taken to the GATT, within 15 to 18 months, whether the GATT has ruled or not. Congress has been criticized for saying that we have to do this in 15 to 18 months. The United States and Canada just agreed to do it in 300 days — 10 months. So that is a very important gain.

Another practical advantage arises from the fact that the Court of Appeals for the Federal Circuit — the appellate court that handles these matters in the United States — has so far given great deference to the decisions of the administering agencies in the United States (Commerce and the ITC). Consequently, if you are contemplating challenging the U.S. government, you would rather be in the new tribunal than before the Court of Appeals for the Federal Circuit. That could change — the CAFC may get tired of the government — but for the moment, that is a practical advantage.

A third advantage is that the panel will presumably be able to remand these cases back to the administrative agency to reinvestigate if there is an ambiguous question or a lack of facts, just as the Court of International Trade does in the United States and the Canadian Federal Court of Appeals has done with the Canadian Import Tribunal. That takes care of a lot of the problems, to which Debra alluded, of being stuck with the administrative record.

The question then becomes, what does it all mean? The best way to answer that is to review some recent history. An impartial tribunal — and I don't claim to know the facts of the case — would probably say that there are still subsidies on Canadian hogs and that there are still subsidies on U.S. corn. I am talking about subsidy, not injury. The

reason is simple. If you go to the public accounts in both countries, there are the subsidies. This really goes back to a crucial matter of public perception. It was never expected, as I understand it, by anyone that there would be an exemption of subsidies from unfair trade law, in the United States or in Canada. The laws in both countries on countervailing duties are similar, with only minor technical differences in calculation. There is no chance that either country will allow the other to subsidize its exports into the first country freely. It's just not on.

Most cases, as I have said, are not decided politically. Is there a subsidy on U.S. corn? Of course there is. Having a different tribunal isn't going to change that. You might get a difference on the amount of the subsidy, but it would be a difference of percentage points, not order of magnitude.

There will be many more fights about injury, because injury is inherently a judgment call. It is like an impressionist painting. I expect the new tribunal to see a fair number of injury cases. My guess is that an impartial tribunal placing itself in the shoes of the agency in each country responsible for injury determinations (i.e., the Canadian Import Tribunal and the U.S. International Trade Commission) will realize what a tough job they have and will usually go along with them. It is not going to make that much difference, day in day out, because most of these cases fall clearly on one side of the line or the other. What matters is the big case.

I was pleasantly surprised that our two countries were able to come up with such an imaginative and unique agreement. This really lets the big case, the Lumber II-type case, go to an impartial binding tribunal. That is unprecedented, and I think it is marvellous. Probably the best aspect from a U.S. perspective is that, despite all the resistance on this question of binding dispute mechanisms, this is what the United States wants in the GATT, and what we have been seeking in the GATT for at least 15 years. We want the GATT dispute resolution mechanism to be faster, more binding, the panels to be chosen quickly from established rosters of independent people. This is the U.S. wish list. I believe the United States should be pleased with the new tribunal is this agreement. The Canada-U.S. agreement will provide a model for everyone else.

Discussion

Gordon Robertson

Frank Stone:

One of the issues in the GATT is the status of the recommendations of panels or recommendations of the GATT council and whether these recommendations need to be or are mandatory on the government's concern. What would be the status of recommendations of panels under the review process or under the general dispute arrangements under the Canada-U.S. Free Trade Agreement?

Debra Steger:

As I see it, Frank, there are a number of different provisions, and again we will have to wait to see the agreement to see how things are really going to work out. Essentially, there are two or three areas where the panel's decisions will be binding, where there is a mandate in the agreement that there is binding arbitration. One of those cases is in the safeguards case, and obviously in any anti-dumping or countervailing duty review, the decision is binding. Also, the Canada-U.S. Trade Commission has the choice when a dispute comes to it to decide that it will use binding arbitration. If it decides not to use binding arbitration in a particular case, then what happens is very much like what happens when the GATT panel procedure is invoked now. The Commission can appoint a panel, the panel goes off and investigates, writes a report and makes a recommendation back.

Then the Commission is to review the recommendation and make the decision on the basis of consensus. That's the way it works where you have an issue that is not an issue for binding arbitration and as I said, in the agreement — at least in the transcript that is available to us — it appears that safeguards disputes, anti-dumping disputes and countervailing duty disputes will always be subject to binding decision making, but that other disputes may be subject to this GATT-like panel procedure system.

Frank Stone:

As a supplementary observation, the proposed general dispute settlement provisions are a considerable advance on the GATT process.

Debra Steger:

Yes without question, since the proposed bilateral dispute settlement arrangement implements proposals for reform of the GATT process.

Ivan Bernier:

I would like to ask Debra whether she thinks that chances are that this will slow down the rate of application to the administrative bodies in the U.S. for dumping and countervailing cases. The other question is, since she said the problem lies with the rules themselves, what are the chances that it will really change something since the new bi-national body will be applying those rules? I can see, in some cases, there will be some effect. I have the feeling that as far as countervailing duties are concerned, there may be some disagreement on problems of causality. We have not mentioned causality which is a major problem. It is not entirely clear that the law is applied as it should be in the United States on this specific question, so perhaps there will be a change there. There was a study by Rugman on the fisheries case, which was a good study. I think this bi-national body could change that area, but, overall, what are the chances that private concerns will still go on with anti-dumping and countervailing duties applications?

Debra Steger:

I think that is really an open question and there are, of course, a number of factors that come into play here. It all depends on what happens to the U.S. economy over the next couple of years and what happens to the U.S. trade deficit, because these applications, these private petitions, are launched for any number of reasons. I would hope that it will have a sobering effect — at least that's the hope of the Canadian negotiators and the Canadian government — on the U.S. Department of Commerce and on the ITC when they are making their decisions. And it may very well be, down the road, particularly with respect to questions of injury and causation, that the panel will provide an important check on decisions of the ITC.

But, as Gary suggested, it is going to be more effective in the big cases. I find it very difficult to do any crystal ball gazing as to what impact it's going to have over the next five to seven years. Gary might have some suggestions, being a little closer to the U.S. economy and the U.S. scene.

Gary Horlick:

As I said before, most cases are not decided politically. The rules in both countries are about the same for dumping and countervailing. The agreement will not stop the filing of petitions. What it will do is reduce the propensity of people filing adventurous or frivolous petitions. For example, there was a report last week that some energy industries in the United States had decided not to file a countervailing duty case against Canadian electricity because it would go before this tribunal and they didn't think they could win before an impartial tribunal. (I can think of a lot of other reasons they wouldn't win.) If people think it is an obstacle, it is an obstacle.

The other side of it is the trivial case. There have been a number of cases, say, countervail cases, by U.S. companies against Canada, that don't amount to a hill of beans. A case was brought on steel pipe. It was less than 1 per cent subsidy. That has no commercial effect. The cases on Canadian flowers were ridiculous. I was counsel for the Canadian fishing industry and we won 6-0 on processed fish and "lost" 3-3 on whole fish. Well, obviously, if you lose 3-3, you are going to run to the new tribunal the next day. To a practising lawyer counselling a client, the fact that you can do that is important. The

client wants to know at the outset what are the chances of winning in percentage terms and how much is it going to cost? Anything that tends to lower the percentage of winning or raises the cost — and the agreement does both — reduces the propensity to file.

Debra Steger:

I might just point out that the substantive provisions of the agreement in a couple of cases I can think of have precluded actions from being initiated in the United States; for instance, the energy provisions, like getting rid of discriminatory pricing for electricity, and also getting rid of the two-price system permanently for other energy exports and also autos and auto parts. The new agreement to get rid of the duty remission program for offshore manufacturers really means that we are not going to see an auto case in the United States.

John Bulloch:

I would like to thank Gary Horlick for putting in perspective the fact that we are magnifying the issue of dispute settlement in the normal transaction of the trade. Lumber issues in Canada so dominate the media that everybody in Canada looking at the free trade agreement somehow feels that dispute resolution is what this trade deal is all about. I can tell you there's literally thousands of companies in Europe and Japan, medium-sized firms, looking at joint ventures in Canada in order to take advantage of this agreement. And there is not one of them talking about dispute settlement, not one of them planning to dump products, and not one of them looking for government subsidies. But what they are all talking about is safety in the streets in Toronto; they are talking about the sensitivity to languages, social programs, and now access to the market. Dispute resolution mechanism is a highly politicized Canadian issue that is not even on the lips of all these potential investors in Europe and Asia.

Gary Horlick:

I ran into a Washington representative of a client the day the agreement was made. He asked me what happened. I started talking about dispute resolution. He said: "No, are the tariffs off? Is the 15 per cent

tariff on my product gone?" I said "yes", and he said "great". That's what he was interested in. Consequently, he will go out and support the agreement, including the dispute settlement mechanism.

Question:

You commented that in almost all cases the existence of a subsidy is not what's in question because you can look at the budget and there it is. That may be true in most cases but the threatening ones are the ones where there is unilateral determination of what the criteria are going to be. That really goes without saying and you can comment on it or not, as you wish. What I want to ask you in that connection, what do you think is the likelihood of changed definitions of subsidization in the omnibus trade bill and what impact you think that will have on how all of this will then proceed?

Gary Horlick:

The cases to worry about, the ones that get the most attention, are those where there is a unilateral definition of what a subsidy is, because governments get most upset about that. Until Lumber II, Canada had done extremely well with the U.S. contingency protection system. It complained about it all the time but, if you look at the results, Canada was not being shut out of U.S. markets by this system. The uncertainty hurt and the legal fees hurt. The lumber cases were the nightmare cases, with a unilateral determination in Lumber II of what a subsidy is, made even worse because it had been determined *not* to be a subsidy three years earlier. You could get the same sorts of issues in dealing with electricity or maybe a few other things.

All other things being equal, the new dispute settlement mechanism is aimed at that problem. It gives you a binding, bi-national decision. It ends the "unilateral" possibility. And remember, the 300 days is very important in that connection. There will not be a unilateral decision because within 300 days it would be gone. And most big businesses can probably live with that.

The question then becomes: "What if Congress changes the law?" Well first, is it likely to? As some of you know, the House part of the omnibus trade legislation would change the definition of subsidy. It is clearly aimed at making countervailable the low price of natural gas in Mexico. This would have implications for lots of things in Canada, and, I hasten to say, the United States: cheap irrigation

water in the United States, cheap inland waterways and so on. We both do the same things. Therefore, it has aroused considerable opposition; the Senate bill rejected it. I can't tell you which way it will come out. However, in the end, I think the opponents will prevail on that subject. However, even if it were in the bill, if the bill is enacted after January 2, which seems likely if it's going to pass at all, it then becomes subject to the standstill provisions and to the general dispute settlement mechanisms. There are things in the agreement that deal with the problem.

The only positive effect of the stock market drop is that it made everyone cautious about trade legislation. No member of Congress wants to vote for something, have the market fall for unrelated reasons the same day, and have some editorial writer blame him in the next day's edition. The trade conference met for the first time last week, and took all the controversial items off the agenda, because the market was down 128 points, as of 11 a.m. To add an historical anecdote about the famous Smoot-Hawley tariff, Senator Smoot and Congressman Hawley both lost in the next election. And that's what deters people in the United States from protectionism.

Going back to your question, new legislation under the free trade agreement would have to mention Canada by name. That would require enormous political effort. The whole thrust of U.S. trade legislation is to make it look like general rules. It would take an extra push to mention Canada by name, and your negotiators knew that. Sponsors of legislation start to lose support if a bill picks out a foreign country by name. Japan's the best example. There's one bill that mentions Japan by name; they had to tone it down in order to do it.

No international agreement can guarantee things perfectly, for the simple reason — much ignored in some of the Canadian press I gather — that in the end, both countries retain their sovereignty. They can both kill the deal. Neither country is going to want to kill the deal. By the time you get to 1990, businesses and workers on both sides of the border will have such heavy investment in sales in the other country, they're not going to let either Congress or Parliament kill the deal. That may sound Pollyann-ish, but what this agreement really represents in a sense is the two governments catching up with what Canadian and U.S. businesses have been doing for years — looking at one integrated North American market.

Jim McCambly:

There's something that gives me concern in tying into a bilateral agreement, and that is there have been comments by the President of

the United States and by Congressman or Senators in the States, that maybe a North American pact, including Mexico, might be a possibility. And so, if we're looking at injury, from a labour perspective, I look at the United States and Canada as being quite compatible in many ways. When we look at some problems concerning labour in Mexico, that's quite a different matter. And so, I wonder where we would be at if the United States said: "Well now we had better make another deal with Mexico because they happen to be another neighbour on the other side", and where would we be at in terms of any injury recourse or the level playing field that we thought we had?

Gary Horlick:

As I understand it, the Canada-U.S. agreement as written would not automatically include Mexico. That would require a separate and new negotiation with Canada, and your concern would have to be taken care of in that context.

Second, knowing Mexico fairly well, I can assure you that it's not going to happen for a long time. If you think Canadians are worried about U.S. domination, it's even worse for a Mexican politician or civil servant to agree with the United States on anything. Mexican nationalism is far stronger than Canadian on the subject of the United States and with good reason. So the kind of agreement that we have with Canada is not likely to be replicated with Mexico in the medium term.

Jeffrey Schott:

Gary, I've been intrigued by many of your comments and they've raised some questions in light of the binding nature of the dispute settlement procedures, and in light of your comments about the basic conformity of our countervailing duty laws. They also raise a question of the real importance of the exercise that was stressed so much this morning of harmonizing our unfair trade laws over the next five years. I can see it in the area of anti-dumping as far as trying to harmonize them out of existence. But in the area of countervail, I'm less sure. Back in the Tokyo Round, Rodney Grey and I and a number of other co-conspirators, worked to harmonize our countervailing duty laws — to mixed reviews. In fact after the smoke cleared, Rodney was not so sure that we weren't worse off with more rules than with fewer rules. And certainly more rules make it harder for the binding arbitration board or panel to rule against the individual

countries because it's following a specific set of judgments, and so there's less discretion. So I wonder if you could comment on whether that's such an important feature of the agreement: to work on harmonization of our national statutes.

Gary Horlick:

Harmonizing — even better, eliminating — dumping law is important. The harmonization of countervail is less important economically, but it's important to eliminate political confrontations that aren't necessary. The U.S. and Canadian countervailing duty rules, in general, make sense economically. The distortion is not the countervailing duty (if accurately measured), it's the subsidy. Determining causation of injury is a real problem, and there's a lot of harmonization of both rules and practice that needs to be done there.

On the question of what a subsidy is, there are a few odds and ends in U.S. law that don't make sense economically, such as our handling of regional development grants. That should be harmonized. And there are a few things Canada does on valuation of subsidies that, in my humble opinion, don't make sense. Politicians are upset about regional development grants and countervail. There is room for harmonization there. But the big economic impact, as opposed to the political one, would come from getting rid of dumping. That said, it's worth adding that these negotiations saw the most interesting work done on subsidization and injury since the Tokyo Round. It's a pity it wasn't public. And that will serve as a useful framework for the Uruguay Round.

Simon Reisman:

Gordon, there's been a good deal of discussion here, and comment on the effort we made to come up with a common set of rules, that would form the basis of trade remedy measures, particularly in respect of Canada. On anti-dumping, I think both sides agreed in principle fairly quickly that we ought to get rid of each country's anti-dumping laws and to move to the anti-trust type of approach. The Americans weren't quite ready for it, although we were. I think we'll probably resolve that one. The big difficulty was on the question of subsidy and countervail, and we did a lot of work there. We didn't get any further than they did in the GATT — they tried for 40 years and failed. We did a big job on that. I think Gary is quite right, and he's familiar with what we did.

I want to make an important comment on this, and I know there are press people present, and I think they'll be interested in it. There is a good deal of foolishness spoken on this subject by the people who oppose this deal. They criticized the deal because it failed to come up with a common set of rules on subsidy and countervail. What they're really saying is not that they wanted a common set of subsidy rules, because I think if they saw the common set of subsidy rules, they would be quite disturbed by them. What they wanted was an exemption from countervailing duties without considering what the subsidy rules would be. In fact, to sum up the criticism, they are saying that we promised them exemption from U.S. countervail.

As Gary has said, that's plain nonsense. No country is going to say "Open season, you have a hunting licence to subsidize and poach in our market". Nobody's going to allow that. We wouldn't allow that into our market and the United States will never allow it into their market. We didn't ask for that, and we didn't expect that.

What we wanted was some certainty; we wanted to know the basis on which we were trading. We wanted to get rid of a good deal of harassment that takes place — the harassment is worse and more costly and more unsettling than the actual cases that come up. And I think we've made some big strides in that respect.

But I do want to say one or two things about this mysterious common set of rules and what went wrong. I made a cryptic comment in my remarks this morning about the Americans asking too much in terms of the discipline and that they themselves weren't willing to be subjected to that. And that's indeed what happened. We were prepared to have a set of rules that would apply to both countries and that would be very strict. They would be rules about what you're allowed to do by way of subsidies. Once you know what a subsidy is, we were prepared to accept some very formidable constraints on their use. They were rules that we were prepared to accept. They drew very heavily from the present GATT rules, from the U.S. countervail law that deals with subsidies and from the Canadian countervail law, all of which are reasonably internally consistent. One of the problems on the U.S. side was that they were looking at the omnibus trade bill and they tried, in devising a common set of rules, to anticipate some of the things that might come up from that new omnibus trade bill.

Well, clearly we weren't going to accept the set of rules that took the present rules and added to them, in some fairly extreme way. More important, let me say what these dealt with. They dealt with resource pricing, of which very little was said. That's stumpage and that kind of thing. It's an exceedingly important issue where we do not believe

that there are subsidies at all, and some of the American interpretations suggest that there are subsidies. Other rules dealt with research and development, they dealt with some of the regional development problems and they also dealt with infrastructure support. And we had good proposed rules about subsidies, we were getting close, we were getting very close, all on the assumption that this would apply across the board, to the Canadian federal government, provinces, the U.S. federal government and the U.S. states.

Well, late in the game, the Americans said they couldn't engage the states. They wanted to engage the provinces, but they couldn't engage the states. Well, you know how possible that would be. Second, they weren't sure they could engage themselves. You see, one of the real problems here is that the whole GATT is founded on a set of interpretations of subsidies which is terribly mercantilist. Export subsidies are terrible; domestic subsidies are not so bad. When a big continental power subsidizes, the consequences don't show up too much, either in volumes of trade or in effects on foreign markets through export. They show up more through import displacement.

Well, we said, this has got to be symmetrical; you've got to have disciplines on your subsidies as we have on ours. The fact that we are a smaller, more specialized economy exporting more doesn't mean that we are not hurt by your import displacement. They wouldn't accept any disciplines on that. So, we didn't get a set of rules in the end.

But you know, we would have been quite happy with a set of rules that reflected the status quo in terms of our present interpretations with subsidy and countervail, in both countries. So, the notion — and this is exceedingly important — of all these people who criticized us because we don't have a common set of rules, would have been aghast that they wouldn't be free to subsidize. What they wanted was a licence to poach. And that's silly.

So what's going to happen in the future? I think we'll make good yards during the ensuing period on anti-dumping. I'm not so sure about how well we'll do about getting a good set of rules over that period in respect to subsidies and countervail, maybe we will. But the Americans will have to turn around in a substantial way in respect to domestic subsidies, in respect to engaging the states, in respect of having a good hard look at their defence expenditures and the subsidy consequences of that.

So, that's where the problem is. Now, what will happen — I'm venturing into very dangerous territory here, but that's never deterred me — what happens if we don't get a common set of rules in the five or seven years that we'll have to work in? As the years go by, and we learn to live with the agreement that we have, and we find that we

have done away with a good deal of harassment, and we find that there are fewer petitions because they know they are going to be subject to this review and appeal process, I suspect we're going to find that we have got a pretty good thing in place. And the urgency of a common set of rules may well fade into the background for the reasons that Gary and Debra have so well expressed.

I want to say one other thing, and that is a more technical point. It's addressed to Debra, but Gary also made a reference to it. It's on the question of "What will this tribunal or panel do for a living? What will it look at?"

Essentially it will look at the same things that the Court of International Trade looks at. And what they look at essentially is the administrative record. The word "administrative" in front of "record" somehow implies a technical or a legalistic or a formalist approach. That is not so. If you examine the cases you'll find that the phrase 'administrative record' includes many components. It consists of all the information that came by the investigating authorities, all the factual material. It includes all the governmental memoranda pertaining to the case, all records of meetings, conferences and hearings held during the investigation. So it's a very big scope of things that they look at.

The reason that I'm taking this time, Mr. Chairman, is that the press asked me these questions this morning and they were misguided. They have no notion of how this bi-national review process will operate. This is not a *de novo* investigation, but it looks at all the facts and the analysis and the application of law to those facts and analysis. So it's a very big thing indeed and I don't have to repeat what Gary said that it will make a big difference. The very composition of these panels — and they'll be commercial policy people, we'll make sure that they are — will ensure better outcomes to the trade cases. This whole business of speed is very important. People have not referred to the court of appeals for the federal circuit, Gary made a quick reference to it, but you know you have a review process now and an appeal process, which can run to four years or more. We now have 315 days. So it's a very very different animal. And you know, I think we've done something very big here. I must say that I got a good deal of encouragement from Gary Horlick's comments on the constitutional issue.

Gary Horlick:

Thank you very much, Simon. If I could follow up briefly on a couple of points: The term "subsidy" as popularly used, goes much wider

than what comes in these countervailing duty cases. Neither the United States nor Canada ever considers programs like unemployment insurance, health care, highway networks, or universities as countervailable subsidies. A lot of what I've seen in the press in both countries says that, under this agreement, we're not going to be able to have National Health Care or Medicare or catastrophic health insurance. That is not true. Aid for Native Americans, aid for the indigent, worker training programs, none of that comes under this category.

A second point is worth mentioning. The United States has had only one countervailing duty case ever against its exports, which was corn in Canada. If there had been 10 cases against the United States instead of one, you would have had a lot easier time negotiating with the United States, because we would have been a lot more sensitive to these things. The United States just hasn't been sensitized the same way Canada has. As the United States in the 1990s becomes a net exporter (because we have to and if it takes 100 yen to the dollar, we're going to be a net exporter), our interests on these sorts of issues are going to change. I think Murray Smith has made that point, and our interests will match up with Canada's. Remember, the countries are very different, but the general tone of government assistance in the two countries is not all that different. Simon Reisman put his finger on it. Our subsidies are through the states. That's why the United States couldn't bind them. Our subsidies go through tax refinancing and tax holidays and free land in the states. When we go out and want a Toyota plant, it's not the federal government, it's the State of Kentucky, which even flew workers to Japan for training. There are plenty of subsidies, they're just not so obvious.

One last point on what Simon said about the administrative record. The administrative record in the United States is anything that went into the administering agency. What that means in practical terms is counsel for both parties submit any scrap of information they think will help them, whether the agency agrees with them or not. It is then in the administrative record that will go to this tribunal. And in a normal, ordinary, routine, garden-variety case, the administrative records will be 50,000 to 150,000 pages. In a big case, such as the steel cases in '82, it's over 5 million pages. We had to go out and buy filing cabinets. The "record" is any scrap of paper you think will help you. This is not a limited opportunity. Any lawyer who doesn't put everything in, has only himself to kick. And the same is true in any civil litigation I've ever seen.

Debra Steger:

That's essentially true in Canada as well, although the scope for judicial review is more limited than in the United States. But I guess that I was thinking more of the small case, where I've seen a number cases, smaller cases, where the producers affected do not get involved in the case until late in the process. The time constraints for an anti-dumping or countervailing duty case in either Canada or the United States are very circumscribed. Unless you get yourself a lawyer quickly and you get yourself a good lawyer that makes sure that he or she gets everything onto the administrative record, then you could end up down the road with determinations against you where you haven't had an input and facts and evidence supporting your case just are not on the record. What I was suggesting is that there will not be an opportunity at the panel procedure for a trial de novo or for new evidence to be brought forward or new analysis of the specific issues and that still holds also in the United States. If an industry doesn't know what's happening to it until it's been hit, it doesn't always get the right information onto the record and that's critically important.

Gordon Robertson:

Well, thank you all very much. I have the impression that we've been let in on the inside of a lot of these negotiations and the procedures and processes of government, and the realities of this whole thing. Extremely interesting.

Investment Aspects of the Canada-U.S. Free Trade Agreement

A.E. Safarian

The proposed free trade agreement between Canada and the United States includes a number of sections on investment and trade. I will outline these sections, then consider two questions: How will approval of the agreement change what the two countries are *now* doing with respect to investment; and how will approval affect what the two countries may wish to do *in the future* with respect to investment?

In broad terms, the provisions with regard to investment are as follows:¹

1. National treatment will be provided each other's investors with respect to establishing new business, acquiring existing business, and conducting, operating and selling established business. National treatment means that, with certain exceptions, foreign-controlled firms are treated no less favourably than domestically-controlled firms in similar situations. More particularly, each party agrees a) that it will not require that minimum levels of equity be held by nationals; b) it will not require forced divestiture; c) there will be fair standards for expropriation and compensation; and d) it will not impose export, local content, local sourcing, or import substitution requirements on the other's investors.

2. However, all existing laws, regulations, and published policies and practices that do not conform with these obligations can be retained. That includes a long list in each country. In Canada, for example, federal or provincial regulations or fiscal measures distinguish between firms by ownership or control in petroleum, small business taxation, land ownership or transfer, various types of agricultural support, uranium production, mining leases in the Northwest, a wide variety of media and some types of transportation. In the United States, federal or state regulations or fiscal measures dis-

tinguish between firms by ownership or control in, among other sectors, land, various aspects of maritime and air transportation, broadcasting and some other aspects of communication, and through reciprocity provisions in insurance and some other sectors.²

3. Canada agrees progressively to raise the exemption level for review of U.S. acquisitions of Canadian-owned firms from \$5 million in gross assets to \$150 million. Review of indirect acquisitions — those where the parent firm's ownership changes — will be phased out.

4. The "cultural industries" are excluded from the investment chapter, presumably with regard to national treatment and to the new limits to the review process. These industries are defined as the production and distribution of print media, film or video recording, music recording and publication, and various forms of radio communication including television, cable and satellite. Where divestiture is required by Canada because of review of an indirect business in such industries, Canada agrees to purchase at a fair value.

5. Canada agrees to give U.S. firms national treatment with respect to ownership of Canadian financial institutions. In particular, this will end the 25 per cent limit on foreign ownership of Canadian bank assets (although not the 10 per cent limit for any one owner) and the limit on the total domestic assets of foreign bank subsidiaries. The United States agrees to give Canadian financial institutions the same treatment as U.S. institutions when the Glass-Steagall Act that limits bank ownership of securities firms is amended. In this respect, and in the inability of the U.S. federal authorities to provide for access to inter-state banking, the guaranteed concessions here are one-sided for the time being.

6. There is agreement to cover a number of service sectors at a later date, applying principles similar to those in the investment chapter — provision for national treatment, right of establishment, right of commercial presence, transparency and dispute settlement.

It is no secret that the U.S. government aimed substantially to free direct investment flows and the restrictions on existing firms, as well as to limit what a future Canadian government might do to restore investment restrictions. The first question I will examine is how approval of the agreement will change what the two countries are doing now with respect to investment.

So far as closed or partially closed sectors are concerned, the answer would seem to be that there will be little change outside of financial services and possibly some other services once the negotiations on these have concluded. Let me repeat that existing laws, regulations and published policies and practices are grandfathered so far as national treatment is concerned. That includes the

ownership objectives in petroleum and the entire cultural sector as defined, with these sectors continuing to be subject to the current regulations on direct and indirect acquisitions and the current rules on divestment when indirect acquisitions occur, subject to a new rule on compensation noted previously. One interesting point about the sectors closed to foreign ownership is that there are no explicit provisions for rollback, on a mutually agreed basis, except in the case of services. Another point of interest is that there are no criteria for deciding when a sector may be closed to foreign ownership at some later date. In other jurisdictions, one finds rules such as public order, security, health and so on that cover such sectors. Presumably the final agreement will address this point.

In terms of review of inward direct investment and acquisitions by existing foreign-owned firms, it is clearly Canada that made the concessions; the United States has no comparable review process. Little has been given up in terms of our actual practice, however, not only with respect to what Investment Canada has been doing since its inception, but also with respect to the way the Foreign Investment Review Agency operated in its last two years or so.

In response to the GATT ruling on FIRA's practices, we had already given up the right to set import requirements as a condition of investment. It is doubtful that export requirements would survive a challenge under Section 301 of the current U.S. Trade Act. Such trade-related investment measures, it should be noted, are also under review in the current GATT negotiations. One possible anomaly remains, however. Under the Competition Act of 1986, increases in exports and substitution of domestic products for imports are part of the efficiency gains test for mergers and for specialization agreements which substantially lessen competition.

"Fair" standards of expropriation and compensation are already in effect (tortuous as the legalities may be in given cases). The questions regarding divestiture due to indirect acquisitions are to be handled by a specific clause in the agreement. Investment Canada does not review new investments. It is true that the direct acquisitions threshold rises substantially and review of indirect acquisitions will end, with some exceptions. If I am correct, Investment Canada has not rejected one of the 2,000 or so acquisitions it has handled to date. About two-thirds of total Canadian-controlled assets will still be reviewable when the new threshold on direct acquisitions is in effect. Review of indirect acquisitions has been used to some effect in the petroleum and the cultural industries, where the existing sectoral provisions are retained.

Thus Canada has not, I suggest, given up very much in terms of its current and recent practices. We will continue to review acquisitions of the 500 or so larger firms, using all the present criteria except for the trade and equity requirements. Existing requirements include effects on competition, on international competitiveness, employment of nationals, a range of research and productivity issues, and conformity with federal and provincial laws. Presumably this means we can continue to negotiate product mandates, R&D, and technology transfer requirements with investors, even though they can affect trade flows at a later time.

The United States, in turn, has presumably given up the right to apply a review process against Canadian multinationals in the event that such a process is introduced against other countries. Thus one can consider the agreement as guaranteeing access to the U.S. market by Canadian multinationals, which have become important investors there, while allowing Canada to continue to review larger acquisitions by U.S.-controlled firms. Considering the strong stand the U.S. government has taken against such review in Canada and elsewhere, this outcome must have been difficult for the United States to accept. It is worth noting that some elements of the U.S. Congress and public opinion were interested in initiating such a review process during the late 1970s as a result of reaction to acquisitions of U.S. firms by investors from Arab countries. It will be interesting to see if any such reaction occurs in response to the current growth of foreign acquisition of U.S. firms.³

The relatively liberal Canadian approach to inward direct investment in recent years, and, indeed, the strenuous efforts to attract it, are part of a world-wide trend. In the 1980s most of the industrialized countries have been gradually opening some of their formerly closed sectors to some forms of participation by foreign-owned firms. They have wound down or ended any review requirements and have increased various incentives to attract direct investment. All this has been in response to two broad factors affecting governments and firms. Governments have had to face an increasing internationalization of their economies, major pressures for international competitiveness and economic adjustment, and increased economic volatility. For their part, many more firms are global in nature, and multinationals are far more varied in their national backgrounds and in the forms their investments take. In some sectors, for example, more joint venturing and other cooperative forms of investment occur. All this has made governments and multinationals far more willing to work together than was the case earlier. Even those less developed countries once strongly opposed to foreign-controlled subsidiaries

are now often prepared to accept them more broadly. And many socialist countries now accept ownership forms of multinational company participation in their economies.

Canada has been caught up in this trend. But Canada has three further reasons for moving away from a policy based on trying to negotiate more benefit from multinationals to one based on attempts to make Canada a more attractive setting for multinational activity, both foreign and domestic. One reason is that foreign control of Canadian industry, which some have dreaded for a variety of reasons, has fallen steadily since about 1970, well before policy instruments like FIRA and the National Energy Program took effect. Foreign control of capital in industry as a whole, except for agriculture and finance, has fallen from about 36 per cent in 1970 to about 26 per cent today. Second, in a world of increased uncertainty, multinationals have concentrated their newer investments in a relatively few markets, with North America (especially the United States) as the major recipient. Canadian authorities have been working hard to capture more of that investment. Finally, Canada's multinationals have come of age very quickly. In 1974 our stock of direct investment abroad as a percentage of the foreign-owned stock in Canada was 20 per cent; today it is at least 60 per cent and rising rapidly. Even allowing for the different age and, therefore, market value of these two stocks, the increase in this ratio is remarkable.

These developments have had at least two effects on policy. One is to lead the Canadian authorities to emphasize some of the concerns of an important *home* country for multinationals, particularly the need for a stable and non-restrictive investment environment for such firms, rather than simply those of a major host country. The other particular aspect is concern about a significant part of Canadian investment abroad, especially in the United States, that has been attracted there because of existing or threatened protectionist measures. In such cases, needless to say, home governments prefer that firms export rather than invest abroad. The agreement will reduce the incentive for such investment from Canada while guaranteeing a more stable investment climate for other types of Canadian direct investment.

Although I have argued that not much has been given up in terms of our current policy practices on direct investment, it needs to be added that Canada has made some potentially significant concessions. We have liberalized foreign control of ownership in financial institutions more than the U.S. side has it in its power to reciprocate for the time being; in this case the level playing field will look decidedly tilted in favour of the United States. We will not be able in

future to review new inward direct investment, or indirect acquisitions below \$150 million in constant dollars, save for the exceptions already noted. Nor, presumably, can we add new restricted sectors unless the final draft of the agreement includes some provision for this.⁴

What one concludes about these potential losses depends on what one thought of the policies in the first place. If you believe they were fundamentally in error — largely wrong about their assumptions regarding the effects of multinationals, and counter-productive in practice — then you will suffer no great pangs of regret over the fact that history cannot be repeated in quite this way.⁵ From this perspective, the agreement does not go far enough, namely, to abolishing investment review entirely in return, presumably, for some substantial concessions from the U.S. side. What would happen then is that we would rely on the Competition Act of 1986 to enforce provisions on mergers and monopolies in particular (and also on extra-territoriality if it can be made to work any better than other policies on this sensitive issue). Competition policy is not a weak instrument for reviewing international mergers, as experience in the United States, United Kingdom, and the Federal Republic of Germany, among others, has shown. Competition policy does not cover all remaining aspects of investment review, however. In addition, one would want some agreed criteria of the sort available in other international agreements defining when new closed sectors can be added, and the trade and reciprocity rules applicable to them. Finally, it is worth noting that every country, with or without a review mechanism or closed sectors, intervenes occasionally when foreign takeovers involve a "flagship" firm closely identified with the country.⁶

Yet the fact is that there are some valid concerns about multinationals, both domestic and foreign. If past experience is any guide, these concerns and a large variety of more dubious claims will become politically irresistible at fuller employment and when resource rents soar. What happens then? What happens if there are simply new and unpredictable developments in this area that raise strong calls for intervention?

In such circumstances, the agreement requires that governments find ways to deal with the issues that do not discriminate by nationality of ownership. The outcome, I suggest, will be to lead governments also to look more closely at the underlying sources or extent of the problems rather than simply to concentrate on the multinational firm. Where remedies are necessary, moreover, the effect would be to apply them to all firms that qualify, whether owned in Canada or the United States, whether multinational or not. The

discipline imposed by this should be salutary, or at least not worse than what happens now. Surely we have had enough of harassing foreign-owned firms for alleged defects in their economic performance, while allowing domestic firms and Canadian multinationals that may impose identical costs to escape from the policies. Or of governments creating problems with their policies and then burdening multinationals with their solutions.

More specifically, we have retained the power to review larger acquisitions on a reduced set of criteria. Presumably we can operate it in low gear, as at present, or tighten up its application at some future time if we wish. We have also in the Competition Act of 1986 what may turn out to be an effective set of civil law proceedings to deal with mergers and monopolies (now called abuse of dominant position) that substantially lessen competition. There are many interesting linkages between competition policy and investment review policy, of which only two will be noted. First, an effective competition policy on mergers and monopolies removes a substantial part of the argument for investment review. Much of the case for such a review was that mergers or acquisitions involving foreign-controlled firms might work against Canada's interest, in that oligopolistic or monopolistic firms were involved, reducing competition.⁷ Second, from the perspective of the probable effects of a free trade agreement on domestic and foreign mergers, the Competition Act of 1986 has come none too soon. Such an agreement has two divergent effects so far as direct investment is concerned (apart from the effects on overseas investors). One is to reduce the propensity in each direction to make investments induced by protection or the threat of it. The other is to increase new investment and also mergers, acquisitions and other forms of non-trade activity in both directions as firms attempt to enter one another's markets by means additional to trade.⁸ It will be interesting to see how well competition policy in each country copes with all this.

Review of larger acquisitions from abroad and competition policy are only two of the instruments Canada retains. In addition, we have the power to use a wide variety of across-the-board fiscal policies that will substantially affect investment, so long as these policies do not discriminate by nationality of ownership. I would argue also that we retain more or less our present power to engage in a wide variety of industrial policies subject only to the investment and trade provisions of the agreement. Of course, if such policies are trade-distorting, they will be subject to U.S. trade law, but they are subject to such law now. Only a strong code on subsidies binding both parties would have changed this, and such a code has not been negotiated, or at least not yet.

Notes

1. The provisions and language are from a Preliminary Transcript, Canada-United States Free Trade Agreement, *Elements of An Agreement*, as released by the Government of Canada early in October 1987. See especially pp. 19-26. Some of our conclusions may be modified by the final text.
2. For details and a fuller list of OECD, *National Treatment for Foreign-Controlled Enterprises*, Paris 1985. The welfare aspects of such "key sector" restrictions are significant, as I have noted elsewhere. When a sector is fully closed, the effect is similar in trade terms to a zero quota on imports. The consequences then depend on how quickly and effectively one can substitute for the investment, assuming one wants to do so in any particular case. In such cases domestic ownership is valued so highly that no trade-off is considered regarding possible losses for lack of access to direct investment. See A.E. Safarian, *Governments and Multinationals; Policies in the Developed Countries*, Washington, D.C., British North American Committee, (1983), Chapter 3.
3. There is an interdepartmental committee that advises on general policy on inward investment and on particularly sensitive cases, but it stops well short of being a review agency as usually understood.
4. One can add that Canada has also given up the power to attract foreign direct investment in automobiles by using duty waivers. This practice might well have been subjected to a countervail test by the United States at some point. See Paul Wannacott, *U.S. and Canadian Auto Policies in a Changing World Environment*, Toronto: Canadian American Committee, 1987.
5. My own evaluations of the major policies are negative on balance for reasons explained more fully in "Government Control of Foreign Business Investment", in J. Whalley (ed.) *Domestic Policies in the International Economic Environment*, Toronto: University of Toronto Press, 1985.
6. See Safarian, *Governments and Multinationals*, Chapter 3.
7. I leave aside here the argument that such firms exist in part because the market for some types of international economic activity is imperfect, a view that pervades much of the literature on multinationals. See, for example, Alan M. Rugman (ed.), *New Theories of the Multinational Enterprise*, London: Croom Helm, 1982. If we are serious about the terms of the Competition Act of 1986, which involves an efficiency gains test when competition is substantially lessened, then we are going to pick up a significant part of the possible gains from foreign direct investment through this means. Competition policy does not cover all aspects of the criteria still involved in a review by Investment Canada, of course. Nevertheless, the need for a review process is substantially lessened when trade and equity requirements are no longer to be used and competition policy has been made more effective by other means. We

note also that the pre-merger notifications have thresholds that generally will be different from what is envisaged for Investment Canada.

Notification is required where two size tests are met: the parties to the merger and their affiliates have assets or sales revenues in Canada exceeding \$400 million; and the assets being acquired have a value or sales revenue exceeding \$35 million. The Competition Act of 1986 also has strong measures against extra-territorial extension of foreign law to Canada, although what that means in practice remains to be seen.

8. For further comment on the effects of free trade on direct investment, see A.E. Safarian, "The Relationship Between Trade Agreements and International Direct Investment", in D.W. Conklin and T.J. Courchene, *Canadian Trade at a Crossroads*, Ontario Economic Council, 1985; and Alan M. Rugman, "Living with Free Trade: How Multinationals Will Adjust to Trade Liberalization", *Business Quarterly*, Fall 1987.



The Services Issues

Jeffrey Schott

Thank you, Gordon. I will be brief — for two simple reasons. First, there are many people in the audience who are very familiar with the subject of services, including those who participated in the negotiation of the agreement on financial services. Second, the agreements in the areas of services and financial services reflect the ongoing effort in both countries to deregulate the telecommunications and financial services markets. The liberalization that has been achieved probably would have emerged in the near future with or without a free trade agreement.

Services

The emphasis of the services negotiations was on rule making. The agreement is an elaboration of basic principles that the United States had broached in bilateral and multilateral forums for many years. Discussion of trade in services began almost a decade ago in the OECD Trade Committee. The U.S.-Israel agreement provided a skeletal framework of rules for trade in services. And the U.S.-Canada agreement put some flesh on that skeleton. As GATT talks move forward in Geneva, this agreement will, I hope, inspire further thinking on how governments can provide multilateral discipline on international service transactions.

The services agreement comprises a set of principles to guide government policy regarding international service transactions. The application of these principles to specific service activities is dealt with in sectoral annexes that provide concrete illustrations of how the rules would affect specific activities. The objective is to establish an

effective standstill on services trade restrictions so that new laws and regulations in these areas do not distort bilateral service transactions. That is a very important objective, because a standstill defines the limits of future government involvement in the regulation of a service activity and, therefore, allows businesses to plan their trade and investment strategies better. Note, however, that the standstill does not require changes in existing policies and regulations.

The principles lay the ground work for this standstill in terms of obligations or commitments regarding the development and administration of federal government policies and regulations that affect service transactions. The principles apply both to services that can be transacted across borders and to those that require local establishment for the production, marketing or distribution of the services. The key principles are:

- transparency of laws and regulations, to enable firms to plan better and to ensure that trade obligations are being followed;
- national treatment, to prohibit discrimination against foreign service providers; and
- right of establishment, or right of commercial presence, to provide appropriate market access guarantees to ensure that the national treatment obligation is meaningful.

A national treatment obligation is only valuable if a foreign firm has access to the domestic market. Market access commitments are thus a necessary complement to the national treatment commitment. They may involve the need to establish in the market, or the need to be able to have access to distribution channels, or the need to have equal access to acquire operating licences for activities in regulated industries. The framework agreement spells this out in terms of a right of establishment or a right of commercial presence to ensure that transactions can be conducted across borders with access to the necessary distribution channels.

These principles take concrete form in the sectoral annexes that apply to architecture, tourism, telecommunications and computer services. Efforts to draft a separate annex on the transportation sector seem to be foundering.

The key point to make about the sectoral annexes is that, although the framework of principles seeks to establish a standstill, the sectoral annexes provide a method to provide a rollback of services trade restrictions. In this way, the agreement seeks to deal with the particular services trade problems that beset both countries. The development and elaboration of sectoral annexes can be a revolving process within the framework of the services agreement; indeed, the treaty provides for the extension of talks to an increasing number of

service sectors. In addition, where appropriate, the annexes seek to develop common standards for the regulation of service activities. Significant progress in this regard is being made, for example, through joint efforts of the Royal Architectural Institute of Canada and the American Institute of Architects. Such harmonization is a key objective for rule making for many aspects of services transactions.

Financial services

Because the Treasury and the Ministry of Finance have responsibility for policy regarding the financial service industries, the talks proceeded on a separate, but parallel, track from the general services agreement.

In most respects, the financial services agreement continues the trend toward deregulation in financial markets that both governments have pursued. Both governments commit to liberalize the financial markets, to extend the benefits to the firms of the other country, and to establish a consultative mechanism to oversee the liberalization. As with the entire financial services pact, the consultative mechanism is separate from the dispute settlement provisions in the free trade agreement, and is to be administered by the Treasury and the Department of Finance.

There is already substantial cross-border activity in financial services. For example, at the end of 1985, Canadian bank assets in the United States totalled about U.S.\$40 billion; similarly, there were 17 subsidiaries of U.S. banks and representative offices in Canada with total assets of about CDN\$11.8 billion. In addition, there are 19 Canadian firms or subsidiaries that are members of U.S. stock exchanges; four U.S. firms are currently registered with the Ontario Securities Commission — they were grandfathered when foreign ownership restrictions were imposed in 1971 — and several other U.S. firms own a minority stake in Canadian securities dealers.

In essence, the agreement would free U.S.-owned banks and other financial institutions operating in Canada from current restrictions on market share, asset growth, and capital expansion imposed against foreign firms. In particular, U.S. commercial bank subsidiaries would not be subject to the 16 per cent ceiling set by the Bank Act on the foreign bank share of the total domestic assets of all banks in Canada. In addition, national treatment would be accorded to new applications to enter the Canadian market from both U.S. commercial banks and securities firms.

For its part, the United States undertook important commitments to safeguard the extensive business operations of Canadian firms in the U.S. market. The agreement guarantees the right of Canadian banks to retain the multi-state branches grandfathered under the International Banking Act of 1978. I know there are still some problems with state regulations in this area, but there is some safeguard at least that those multi-state branches will be maintained. The agreement also provides national treatment for Canadian financial institutions under prospective amendments to the Glass-Steagall Act. Although one can't predict how that Act is going to change in the near term, it's clear that it is going to change and change dramatically — the free trade agreement ensures that Canadian financial institutions will be protected so that they receive national treatment under any changes in the Glass-Steagall Act or related laws.

The agreement on financial services reflects the trend toward deregulation that has emerged in both countries in recent years. In Canada, substantial steps in this regard were announced last December regarding opening the securities industry to other Canadian financial institutions and to new foreign ownership. The 10/25 rule, which had limited foreign participation in Canadian firms to 10 per cent by a single firm and to 25 per cent by all foreigners, is now being phased out. Limits on the share of foreign ownership are scheduled to expire next June. At that time foreigners will be allowed to acquire Canadian securities dealers or to establish subsidiaries in Canada.

In the United States, efforts have also been made to push deregulation of financial markets and, in particular, to break down the barriers set by the Glass-Steagall Act. To those who ask what effect the recent developments on Wall Street might have on prospects for reform of Glass-Steagall, I offer the standard economist's response. On the one hand, the developments on Wall Street have led to a certain caution in the Congress toward totally breaking down the barriers between commercial and investment banking enshrined in the Glass-Steagall Act. If reforms are made, they will likely include safeguards that maintain some restrictions on non-banking activities. On the other hand, just like other aspects of the financial services industry, market developments might drive government policy. This seems to be occurring already at the state level. Moreover, if there are some notable failures in securities houses in the coming months as a result of the Wall Street developments, commercial banks — through their bank holding companies — may be forced to get into the securities business. As a practical matter, you may then see a situation evolving in which Glass-Steagall becomes more and more irrelevant.

So I have to leave you with an either/or response. But it reinforces the main point on the financial services agreement: the agreement is following what is going on in the marketplace, reinforcing the trend toward deregulation and providing greater certainty for bilateral transactions in the financial services sector. As such, it is a very significant and useful pact.

Comments On Implementation And Durability

C. Michael Aho

This has been a long and excellent discussion, and it's always difficult to be the clean-up hitter, especially if you are number eight. I always thought the clean-up hitter was number four — maybe even five — but not eight. There is a lot I might like to cover, and I always feel that when you cannot compete, it is best to be provocative, particularly at 4:45 when people may be ready to fall asleep. So if I am provocative, I apologize in advance.

I was asked to talk about three things. First, the implications for the Uruguay Round; second, the prospects for implementation in the United States, and third, the durability of the agreement, including the implications for third countries. In the interests of time and organization, I will make a list of my comments.

What are the implications for the Uruguay Round? The simultaneity of the bilateral and multilateral negotiations means that, on the one hand, a successful bilateral could be a catalyst for things multilateral; but, on the other hand, the bilateral is constrained by the multilateral. Four or five comments are in order.

Number one — these negotiations have, without doubt, provided a valuable learning experience for both countries. Most of the issues being negotiated in Geneva are the same as those negotiated bilaterally. You learn to negotiate by negotiating; we both have learned a great deal. You learn the pitfalls, the problems, the stumbling blocks as you go through the negotiating process. And when you bring back tentative deals and show them to the domestic constituencies that you have co-opted, they also learn in the process. In this manner the trade-offs are explored, the political sentiments are assessed, and political leaders are forced to confront tough choices.

For years, the U.S. Congress has been talking about the need for greater discipline in subsidies, and for rules covering services, investment, and intellectual property. But no one ever asked the U.S. Congress to do anything or to give anything in exchange for greater discipline or new rules. The trade-offs were largely unexplored. But during the consultation process of this negotiation, the Congress became better educated. And the private sector also learned a great deal. They both learned that services are heterogeneous sectors, and they learned about the pitfalls and stumbling blocks in some of our service sectors like shipping and transportation. Services are not just a collection of sectors in which the United States has a competitive advantage. Our negotiators can now take these lessons to the negotiations in Geneva.

Some of us on this panel have written about how these bilateral talks could result in pioneering path-breaking agreements that can serve as a catalyst for the Uruguay Round.¹ To some degree, I think these talks will be a catalyst. We have gone further and faster in areas than we otherwise could have. Consider how tough the going has been when our two countries were sitting down to negotiate in many of these areas — particularly the new areas of services, investment and intellectual property. What happens when 102 countries sit down, where the common denominator is much lower than between Canada and the United States? I think we have gone further faster, and I hope we will be able to table some of these agreements in Geneva and accelerate that process. Good progress was made in services and investments. The disappointment was in the area of intellectual property. (Let me say parenthetically that, on the intellectual property issue, there are some unhappy people in the United States). We will have to continue to negotiate this area in the multi-lateral talks. Perhaps some progress was made behind the scenes that I am unaware of. If so, then even here our negotiators will be better prepared for Geneva.

If this agreement is successfully completed, it could have a valuable demonstration effect on the U.S. Congress. International negotiations lack credibility in the U.S. Congress. The U.S. Congress thinks that the U.S. government has always sold itself out in international trade negotiations. The Congress is looking for some way to solve problems, but it believes we cannot solve problems through international negotiations because they lack credibility — they never yield anything substantial. But maybe, in this U.S.-Canada deal, we have solved some problems; we have achieved something substantial. The way we will know that is if the private sector in the United States (and in Canada) comes forward and vocally proclaims: "This is what

we have always wanted. This is something concrete." The private sector will be the ultimate judge of the agreement. If it believes the agreement is a good one and if it speaks up and tells its elected representatives, there will be a salutary effect on the trade policy process in the United States, and the prospects of the Uruguay Round will be improved.

Making trade policy is a delicate balancing act, even in the best of times. It always pays for the import-competing interests to complain and to ask for government help and protection. But under normal circumstances, a countervailing force of exporters and those interests with a stake in the open market can be mobilized to tell the other side of the story. Still, the last seven years have been anything but normal in the United States. U.S. exports in 1986 were less than in 1980. When exports are flat or declining, you cannot count on that countervailing force to balance against the complaining interests. Congress has been hearing only one side of the story. So if the private sector speaks up and begins to tell the other side of the story, trade policy making in the United States will be improved and the Uruguay Round will have more credibility.

I have co-authored a book in which I concluded that the Uruguay Round would be different; it will be more difficult and probably last longer than any of the seven rounds that preceded it.² It could take 10 years; but the U.S. Congress will not wait 10 years for results. Here again, a successful conclusion of a U.S.-Canada trade agreement could enhance the prospects for the Uruguay Round. If the agreements in these new areas break new ground, they could help to shorten the duration of the Round and bring it to a successful conclusion before the U.S. Congress loses its patience.

A tension exists between what is general and what is unique. Where the United States is demanding services, investment and intellectual property, it hopes that any agreements can be generalized by extending them to cover other countries. But where Canada is demanding contingent protection and dispute settlement, the United States would prefer that the agreement stress the uniqueness of the bilateral relationship. I have written elsewhere that the probability that the U.S. Congress will accept changes in U.S. trade laws and procedures is greater if those changes apply uniquely to Canada.³ The U.S. Congress is wary of setting a precedent that other countries may request during multilateral talks. I am unaware whether there is a similar reluctance on Canada's part in the new areas of services and investment. Would Canada want any completed agreements in these areas extended to other countries?

What are the prospects for implementation in the United States? Implementation will depend critically on four factors — the fate of the omnibus trade bill, political leadership by the administration, the “selling” ability of the private sector, and the timing of the implementing legislation.

Let me begin with some comments on the relationship between Congress and the administration. The Congress is extraordinarily frustrated with the administration on trade matters. It has lost confidence in the President’s ability to conduct trade policy. That is why the Senate and the House of Representatives have drafted unprecedented omnibus trade bills — unprecedented in scale and in scope. Twelve committees in the House and nine committees in the Senate contributed to these bills that exceed 1,000 pages in length — compare that with our most significant trade legislation, the Reciprocal Trade Agreements Act of 1934, which was 3 pages long.

The House and Senate are in a conference committee; its size is unprecedented — 200 members. The challenge is for the administration to negotiate successfully with the conference committee to obtain a trade bill that the President will sign, and one that does not disrupt the trading system or alienate allies.

The administration will also have to send implementing legislation to Congress for the bilateral agreement. But before submitting it to Congress, the administration will negotiate the words of that legislation with members and staff of the key committees, the House Ways and Means Committee and the Senate Finance Committee. These are the committees that have also the lead role in the conference committee. Implicitly or explicitly, the implementing legislation and the omnibus trade bill will be linked, if for no other reason than that the key players are the same.

What would happen if the President had to veto the omnibus trade bill? I am afraid that Canada would get caught in the cross-fire. I am not saying that the deal will be scuttled, but it will certainly take longer to complete. The authors of these trade bills will be more than slightly annoyed if their handiwork, on which they have conscientiously worked for months, is vetoed by the President. That would not be an opportune time for them to focus on the implementing legislation for a bilateral pact.

Under the fast-track provision of U.S. trade law, Congress must vote on the implementing legislation within 60 legislative days of submission, and no amendments are in order. The current fast-track authority expires on January 3. So the President must sign the agreement by then, but as a purely legal matter; there is no requirement for when the implementing legislation must be submitted.

Tactically, then, I would recommend that the administration withhold submission of the implementing legislation until it knows whether a trade bill has been successfully negotiated and whether the President will sign. At the pace the conference committee is proceeding, that will not be known until early next year, and there is some chance that the trade conference could drag into the spring. But, of course, the administration cannot wait too long, because elections in both countries are approaching.

Can the administration successfully negotiate both of these trade bills with Congress? No, not on their own. They lack credibility. An active, vocal private sector will be required to ensure a successful conclusion on both bills. Congress needs to hear the other side of the story. My hope is that once the details of the agreement become known, the private sector will mobilize to sell the agreement to Congress. The private sector has been lobbying against the more heinous provisions in the omnibus bill, but that is primarily damage control. The bilateral agreement could give the private sector something positive to lobby about.

As it now stands, the Coalition of Service Industries and several of the large multinational corporations with large Canadian investments seems pleased with the agreement in principle, but they are all waiting to see the details. Unfortunately, some that would normally be quite active are disappointed over the pharmaceutical issue and the lack of anything significant on intellectual property. But, on the whole, the outlook is good. I hear few major complaints from Congress over the agreement in principle. But I would not expect to see implementing legislation completed before late spring or early summer of 1988.

How durable will the agreement be? An agreement such as this sets up a whole host of legal, political, and institutional questions. Ideally, you want an agreement that is strong enough to hold together over time, and yet flexible enough to evolve with changing circumstances. Much of what I have to say raises more questions rather than providing answers.

First, this is not an ideal agreement by any stretch of the imagination. The failure to develop a common set of rules to govern subsidies and to reach an agreement on intellectual property protection are two of the more obvious drawbacks. But it is a good agreement, and we should not allow the best to be the enemy of the good. Our task is to make the good better. But how will the deficiencies be filled in? Apart from the provision for five to seven years of negotiation on subsidy rules, how will the other provisions be expanded or clarified? If they are expanded, how will they be implemented? That will

depend on the availability of fast-track procedures in the United States and perhaps the concurrence of the provinces in Canada. My reading of the agreement in principle leaves open the question of how future negotiations on the various institutional arrangements specified will allow the pact to evolve.

Second, any bilateral agreement raises questions about third countries and the treatment of outsiders. What if the United States should wish to enter into another bilateral agreement? The problem with bilateral agreements is that when a second bilateral agreement is entered into, it tends to undermine the expectations engendered by the first. Certainly if the United States and Mexico entered into a substantive bilateral pact (and let me hasten to add, neither Mexico nor the United States would be so inclined for years to come) including automobile trade, Canada would be affected. What is Canada's say in future bilateral agreements that the United States may enter into, or vice versa? Do we jointly decide, and how do we jointly decide?

In general, can third countries accede to the agreement or to a part of the agreement? Again, who decides, and how? How will an agreement reached at the Uruguay Round affect the bilateral agreement? Such questions could and will be faced in the future.⁴

Third, both countries were constrained by the Uruguay Round negotiations. For example, the United States did not want to go too far on agriculture. Its major complaints are with the European Communities. If the United States and Canada were to change their farm programs fundamentally, as part of the bilateral agreement, then they would both have fewer bargaining chips and less leverage in the multilateral talks.

But what happens if contentious issues like agriculture do not get resolved in the Uruguay Round? Perhaps what we need is a sequential negotiating process by which Canada and the United States agree to re-contract after the Uruguay Round is completed, in order to improve the bilateral agreement. That would enhance durability.

Finally, a question often posed by Canadian friends: Will the United States hold up its side of the bargain? Definitely, because if there is a completed agreement, it will be the result of an active, vocal private sector "selling" it to Congress, explaining that this agreement is in the private sector's commercial interest. On completion of the agreement, the private sector is going to respond to the provisions by investing, planning its sourcing and operations, and redirecting resources. The private sector will have a vested interest in the pact's integrity. If someone proposes abrogating or undermining the pact,

the private sector will mobilize in opposition. That is why I am confident that the United States will stick to its side of the bargain.

The problem with batting clean-up after such a group of distinguished experts is that I knew most of my thunder was going to be stolen one way or the other. With that in mind, I decided to compose something that could not have been covered.

Could Canada and the District of Columbia complete and then continue this comprehensive commercial compact? For me, the crux of the matter is the creation of consensus between and within both countries. Consider a cynical concluding comment on consensus construction.

Conflicts and confrontations are complex and will continue. Chronically complaining constituencies confound Congress and the Commons and co-opt both capitals. To confuse and complicate matters, both countries are confronting the challenge of constantly changing circumstances and the chorus of constituents concluding that curtailing change is costless is compounding. Consequently, complaining constituencies, as well as Congress's customs and culture, constrained this commercial compact.

Consider the constraints: Congress could not contemplate changing countervailing compensation. Canadian culture could not be compromised. But still, both countries saw they had common concerns and closed a contingent compact. Now can they capitalize by collaborating in a common cause and completing that compact?

Can the Conservatives create a coalition of consumers, commoners and corporations conducive to completion? Can Congress comprehend what a catalyst this commercial compact could be and that the consequences of a collapse could be counter-productive? Critically, can a consensus be constructed of the common commercial concerns confronting both countries?

Certainly, with communication, consultation, consideration (not condescension), coordination, cooperation and compromise, combined with coherence, consistency, continuity, creative contingencies and common compassion, consensus can be constructed; controversies can be controlled; conflicts can be contained, and the compact can be concluded and continued.

That concatenation was convoluted and cumbersome, I concede and confess. But if Canada and the District of Columbia cannot co-opt complaining constituencies and cannot concur on a cooperative, collective conduct, could a crisis caused by a collapse of the compact concentrate the cranium? We'll see.

Notes

1. See, for example, C. Michael Aho and Marc Levinson, "A Canadian Opportunity", *Foreign Policy*, Spring 1987, and Richard Lipsey and Murray Smith, *Taking the initiative* (C.D. Howe Institute, 1985).
2. C. Michael Aho and Jonathan D. Aronson, *Trade Talks: America Better Listen!* (New York: Council on Foreign Relations, 1985).
3. In Murray Smith, Gary Horlick and C. Michael Aho, *Bridging the Gap: Trade Laws in the Canadian-U.S. Negotiations* (C.D. Howe Institute, 1987).
4. For a more complete discussion of third country issues and of how the bilateral will affect the multilateral, see William Diebold, ed., *Bilateralism, Multilateralism, and Canada in U.S. Trade Policy* (Ballinger for the Council on Foreign Relations, 1988).

Discussion

Gordon Robertson

Daniel Roseman:

I have a question about services, in particular telecommunications. In the agreement, it's specified that a number of detailed issues have been agreed to — access to full period, flat rate, private line service and dedicated inter-city voice channels, for example. Also structural and other separations between related basic and enhanced service providers are required. Moreover, Canada and the United States apply the basic/enhanced distinction in different ways, and the FCC, which invented this distinction, is finding it unworkable. A concern with this sort of agreement is that you may be entering into too much detail, and more rules may be worse than fewer rules. The point is that we may be setting up rules that limit our ability to adjust to change in the future. This is a very progressive attempt to try to deal with services; it's very innovative. But there is the danger of going too far with detail. I suggest that we may be making our lives more complicated by trying to deal with things in detail, rather than just trying to develop a broader framework where we're agreeing to national treatment and a lot of other procedures and principles.

Jeffrey Schott:

I think that was more of a comment than a question, but I share your concern. Not being the negotiator, I can just read into this what you

do, and note that the key emphasis was on non-discriminatory access. That, in and of itself, I think, does not raise the same sort of problems that you envisage from some of the other regulatory decisions. Other aspects dealing with enhanced telecommunications services may, and they involve "best efforts" disciplines on cross-subsidization. And what kind of rules do you impose to try to enforce that? I think, in that sense, that we have to wait and see what the detail looks like, because that will really determine whether your concerns are justified or whether they've been met.

Simon Reisman:

Just a comment on that. I think we should be clear that the services chapter is a "futures looking" code in very broad terms. Enhanced telecommunications are dealt with in an annex, it's a sectoral annex, and I don't think there's any way in which you can deal with these sectors without getting into quite a lot of detail. Perhaps I can explain it this way: in the goods field, you develop a set of principles and then you negotiate about tariffs. When you negotiate about tariffs you're dealing with thousands of items and thousands of pages of specific detailed items and sub-items. In the services field, where you don't have a tariff, you have regulations. When you're doing a sector negotiation and where you have a roll-back in respect to existing practices, you've got to get right into the same kind of detail on regulations. And that's why it looks complex. But you are really looking at annexes and not at the agreement as a whole when you refer to that complexity. I don't think that you can look at enhanced telecommunications as an example and go about it any other way.

Just one other comment while I've got the floor, and that's the scope of the annexes. A reference was made in the comments to transportation and whether we have a sectoral agreement on transportation. The answer is no. We have a "futures-looking" arrangement on transportation and even that is causing a lot of trouble in the United States. As you may or may not know, we did have a very good proposal for a full sectoral agreement on transportation, and Canada talked about road, rail, air and marine. And the United States couldn't buy it. They would've loved the stuff on trucking and inter-urban busing, but they couldn't move on marine. They've got the Jones Act, one of the most restrictive, protectionist pieces of legislation ever devised. And not only are the marine people who support the Jones Act complaining about having a sectoral agreement on marine, they don't even like the forward-looking agreement because

somehow it will inhibit new discriminatory arrangements. They're busy in Congress right now proposing restraints in a legislative form on having any reference to transport at all. So that's why we don't have transport in there. This may sound a little immodest, but we were taking the battle to the Americans every inch of the way. These great freedom-loving United States of America were not ready to go the distance that we were prepared to go in dismantling restraints in the services area, even though it was the United States that internationally had been ballyhooing the need for rules and regulations in the services area. We've learned a lot that we're going to carry to the GATT, and we're going to push them a little harder, even on the Jones Act.

Questioner:

I'd appreciate it if some of the panelists would address a little more directly, the whole question of significance of state regulation. And if they wish also, provincial regulation in relation to some of the matters that have been talked about most recently. For example, how important have been state regulations in the area of investment in the negotiations, and how does one contemplate the future harmonization if they are important, to those kinds of regulations. I think also, it could apply to the service sectors, very importantly, because of many of the services that are regulated primarily by the states and provinces, as was pointed out earlier.

Ed Safarian:

I'll just make a brief comment on investment. At the state level, there are a number of problem sectors; about 30 of the states have restrictions on foreign land ownership; and a number of the states have restrictions on insurance companies that impact more heavily on foreign firms than on domestic firms. So, a number of closed areas, or closed sectors presumably will be grandfathered. But I would have thought the more important issues, from a Canadian point of view, would be failure to get an agreement involving state purchasing at the state and the provincial level. Also we pay a fairly heavy price in this country, because of course, there is inter-provincial discrimination through state purchasing requirements of one kind or another, that favour local, rather than inter-provincial or foreign suppliers. But you have a lot of these in the United States as well, and a lot of our

firms, for one reason or another, have developed a capacity to deal effectively with governments. I don't know whether it's because we have more government or what it is, but in things like urban transportation, telecommunication, hydro-electric power, and so on, we have a capacity to export a lot. Our firms have a comparative advantage, if you wish, to deal with governments. And a lot of them have been attracted down to the United States in the last 15 years or so by state governments which say, you set up a plant here or you don't sell to the state government, and we're your main market. So, in that respect there's disappointment. One of the disappointments I have in what I think is a good agreement is that more progress wasn't possible on the state and provincial level. Of course, I know that would have run up against a very important constitutional question, in Canada, perhaps less so in the United States. But that has a very important effect on investment. It continues to attract Canadian investment to the United States when I assume we'd rather see it exported from Canada rather than have to locate there.

Jeff Schott:

I think your concern is well founded with regard to services. There are particular problems, for example, that arise from state regulation of insurance. I already mentioned some of the problems with the state role in banking. I think what will need to be done in this area, is to deal with the problems on an ad hoc basis in the context of multilateral negotiations on services. The effort to try to co-opt the states as a group into an agreement, whether it would be bilateral or multilateral, is not worth the political price that one would have to pay. It makes much more sense to me as a sort of practical negotiator to go and buy off the states, concession for concession. And where there are problems, and there are only a few states where there really are significant problems that foreign countries have in the United States with regard to state regulation of various service activities, you go in and in the context of the overall package, where state industries of both goods and services will benefit, you get commitments of a somewhat binding nature from that state that they will conform their regulatory policies to some internationally agreed standard that comes out of the negotiation. I think that's the way you deal with it. I don't think it was possible to do it in the context of a bilateral negotiation, and I hope governments will move in that direction in the GATT talks. That is my individual view. I don't know if it's shared yet by the U.S. government. I've been trying to convince them of it for the last couple of years.

Question:

This is a question for you, Mr. Robertson. Does Parliament vote on the free trade agreement?

Gordon Robertson:

The legal situation, or possibly I should say the constitutional position, is a complex one. You have to distinguish between approval of the agreement, implementation of the agreement, and the position of the provinces.

So far as approval of the agreement is concerned, the answer is that, as a legal matter, there is no need to have any legislation by Parliament in order to have approval of the agreement by Canada. If you look in the British North America Act, or as it's now called, the Constitution Act 1867, you won't find any federal power to negotiate treaties. Historically, the power to enter treaties was a part of the royal prerogative. In 1867 the royal prerogative in that respect was exercised by the British government, not by any part of the Canadian government at all. It was during this century, as Canadian maturity as a nation developed, that our government gradually took over the exercise of the royal prerogative. Constitutionally, it still is a matter of the royal prerogative, and the entry into a treaty by Canada is on advice to the Crown by the Government of Canada. Constitutionally, no law or approving bill is required from Parliament.

However, a constitutional convention has developed that no important treaty or international agreement will be ratified by Canada without a resolution of approval by the House of Commons and the Senate. The present agreement is not technically a treaty, but it is probably the most important agreement that has ever been entered into by Canada that is in prospect. That being so, the idea that the government would approve it without observing the constitutional convention and having a resolution of approval by the House of Commons and by the Senate is just absurd; it is out of the question. So, at the appropriate time, a resolution of the House of Commons will be sought and got because the government has a majority in the House. The problem arises about the Senate's approval. The resolution of the Senate is as important under the convention as the resolution of the House of Commons. If they chose to dig their heels in and not approve a resolution, it would be for the government to decide what to do. Would it go ahead, regardless of the Senate's position and regardless of that constitutional convention, or would it not? It could argue that the agreement is not technically a treaty and

does not require a formal ratification, but that would be a very thin and dubious position.

Implementation of the agreement may require action by Parliament. From what I've heard, legislation will be required for some parts of the agreement. If so, it has to pass the House of Commons and the Senate.

Coming finally to the position of the provinces, neither the Government of Canada nor Parliament can override the powers of the provinces, regardless of what the agreement says. The Government of Canada could not, by approving this agreement, make it legally necessary for the Government of Ontario to change the way it handles wine pricing in the Liquor Control Board of Ontario. That doesn't necessarily mean, as I understand it, that the Government of Ontario would have to pass a law to comply with the agreement. All the Government of Ontario would have to do for the agreement to be completed as far as Canadian implementation is concerned, is observe it in actual conduct — observe it without passing any law. Just do what it says. If it doesn't do what it says, there's no way the Parliament of Canada or the Government of Canada can force it to do so. In that case, what would happen? I don't know. I would ask, perhaps, Simon Reisman what would happen. Would it be a matter of retaliation on the American side? Could they, in effect, say to us: if you won't mark up our California wine, in a non-discriminatory way, we'll see that you won't sell any Canadian rye whiskey in the United States? I don't know.

Question:

With respect to parts of the agreement that fell under federal jurisdiction, would it be possible to avoid legislation and have implementation by Order in Council?

Gordon Robertson:

I haven't the slightest idea. I don't know whether Simon can give an assessment or maybe Debra Steger.

Debra Steger:

It's a little bit different from the U.S. situation. In the United States you do have to have an implementing bill, and it has to deal with

pretty well all the aspects. In Canada, as Gordon was saying, legally you only have to have implementing legislation in areas where you had legislation before that requires change or where you're going to spend some new money or where you're affecting the private rights of citizens. If you had policies, as Gordon was saying, like the Liquor Control Board policies, that were just unwritten policies, ministerial directives, or something like that, then that's the way that you would change those policies. You would use exactly the same mechanisms. If, on the other hand, you used regulations to implement a certain policy or program, then you would use regulations — or cabinet orders to change what is currently the case. If the particular areas are being regulated largely by legislation now and changes are required in the legislation to accord with the agreement, then it would be legislation. So, in Canada, it's really a mixed bag and it depends on the particular instrument that is being used now.

Question:

Then will implementation depend on what category of legislation or regulation the different elements of the agreement affect?

Simon Reisman:

Let me give you an example. I'm not going to go through the litany of stuff but, take the tariff, which is very a large part of the agreement. If we're going to dispose of the whole tariff, that can be done by Order in Council pursuant to the terms of the Tariff Act itself. There are many, many other provisions that can be handled that way, but certainly a lot of legislation would be required as well.

Gordon Robertson raised or commented on a point but didn't come to a conclusion. What do you say with Ontario, and why? Ontario has a number of things to do in respect of the Liquor Control Board — wine is the big one, there are a couple of things on white spirits, all in Ontario's favour. I'll tell you how I used to answer this, Gordon, because, like you, I ducked. I would say: We're going to get such a good agreement that everybody involved, including the provinces, will be glad to implement. Well, that's before all the foot-dragging that we observed. But in respect to wine, I'd say: that the deal we made on spirits is really so favourable to Ontario, which has a very large industry and a mass of exports at the United States' expense, that the pressures on David Peterson from the industry will be such that I think he'll move along with the wine thing, provided

the federal government will help him along a bit with the grape problem, with the grape growers.

I think he'll do it all right, and I might just, as an aside, say that the same problem came up at the end of the Tokyo Round, where the Americans were pressing on wine but found that the federal government was not in a position to make a binding commitment. They said if you can't and if the two provinces, Ontario and British Columbia at the time, won't fall in line, we're going to remove all the concessions that we offered you on spirits. It so happened that I was in the consulting business at the time, and distiller Seagrams and Company retained me to see what I could do. So I went around to see Bill Davis and laid out some of the facts for him and persuaded him that it would be a good idea to write a letter of commitment. And we kept the concessions on spirits on the table. So there were negotiations after the negotiations, and I think they'll fall into line.

There's really so little in the agreement that requires provincial action. Even the people that are objecting in the provinces — I think it'll boil down to Pawley in Manitoba, who just doesn't like the thing at all as part of the NDP philosophy; you have Joe Ghiz of Prince Edward Island, and he's saying a lot but I don't think there's anything for him to do in this thing; and there's David Peterson of Ontario, which is damned important. I think in the end, he'll come through in the one area where he's got to do something. You've identified it, and that's why.

Mr. Robertson:

As far as I know, nothing requires formal provincial approval or formal provincial legislation as long as there isn't action that contravenes.

IV
What does it mean
for Canada

Canadian Trade at a Cross Roads

Pat Carney

I am very glad to participate in this important conference on what is clearly one of the most historic initiatives ever undertaken by this country.

Whether you support or oppose free trade, I think you will all agree that the Canada-U.S. Free Trade Agreement represents a turning point for Canada in our history as a trading nation.

Prime Minister Mulroney has referred to this initiative as "a declaration of confidence in ourselves, confidence in our ability to compete with the best in the world, confidence in our ability to adapt in a tough and demanding international environment".

This agreement presents Canadians with one of the greatest economic opportunities this country has ever known. It will set Ontario and all other regions of Canada on a new path of innovation, dynamism and prosperity as we move forward into the next century.

No province has benefited more from progressive trade liberalization than the province of Ontario. And yet, the people of this province have adopted a very ambivalent attitude to the further liberalization that the Canada-U.S. agreement will bring.

I want to take this opportunity tonight to reassure Ontarians that the fears and apprehensions that they have are simply unfounded.

From the outset of the negotiations, we made it clear that any deal we reached with the United States would have to be good for all regions of the country. I can say with confidence that this deal is very good for Ontario. And I firmly believe that the people of Ontario will come to share my view as they learn more about the details of the agreement.

I hear concerns raised in this province about the impact the agreement will have on issues such as our political sovereignty, our

social and regional development programs and the automotive industry. Unfortunately, the free trade critics in this province have managed to spread a tremendous amount of misinformation, doing Ontarians a major disservice in the process. Here are the facts.

Let me begin with an industry that is critical to the economy of this province — the **automotive industry**.

Under the agreement, the Auto Pact, including the safeguards, remains in place. This is what the Canadian Auto Workers wanted, what the auto parts industry wanted, and this is what the province of Ontario wanted.

The essential point is that the free trade agreement will ensure the prosperity we have long enjoyed under the Auto Pact by retaining or enhancing its key provisions.

Under the agreement, the Auto Pact companies retain the right to import vehicles and parts duty-free from third countries.

And the agreement toughens the North American content requirements for automotive products not covered by the Pact. This will encourage Japanese and Korean automakers to purchase more parts from Canadian manufacturers in order to gain duty-free treatment. This, of course, will lead to increased employment in the Canadian industry.

Given these very positive elements in the agreement, the CAW's adamant opposition is hard to understand. As *The Financial Post* said this week, "Free trade in autos has enriched the CAW to the point where they can afford to launch glitzy ad campaigns."

What about trade in services, another important element for this province? Ontario professionals and service firms — from architects to engineers — will be able to expand and grow as they seize the new opportunities made available by this agreement.

And no part of Canada will be better positioned to seize these opportunities than Ontario.

On the key issue of **investment**, the free trade critics in this province are anxious to say we have given up the store. This is nonsense. In fact, the agreement will provide secure access and non-discriminatory treatment for Canadian investors in the United States while retaining our right to review significant American investment in Canada.

I ask you, what province has gained more from investment than Ontario? One need look no further than the auto industry to see the prosperity that U.S. investment has brought to Ontario.

In dealing with **energy**, Canada and the United States have agreed to eliminate a range of specific trade barriers. However, the agree-

ment maintains our capacity to decide whether to impose restrictions for reasons of short supply or conservation.

The agreement will provide more secure access for Ontario's electricity exports to key markets in New York, Vermont and Michigan.

In terms of **government procurement**, Canadian firms will be able to compete for at least CDN \$4 billion in additional U.S. government business. This is an opportunity that the Ontario government has sought for over 20 years.

On the issue of **agriculture**, the Canada-United States Free Trade Agreement preserves our ability to manage and choose our agricultural support policies. We made a commitment to Canadians that our agricultural marketing systems would remain untouched. We have honoured that commitment.

Another accomplishment of the agreement will be to phase out all remaining **tariffs** over 10 years. Although much Canada-U.S. trade is currently duty-free, there still remain certain significant tariff barriers that impede commerce between the two countries.

The agreement we have reached will not only liberalize the remaining trade that is currently impeded by tariff barriers, it will also open up an array of new trade opportunities not currently available to our exporters.

For consumers, tariff elimination will mean lower prices and greater selection of manufactured goods as well as food. For our exporters, it will mean greater opportunities. For our producers, it will mean increased domestic processing and manufacturing as well as better productivity and international competitiveness.

Fewer obstacles to further processing of our resources prior to export will be particularly beneficial to Northern Ontario and our petrochemical industry. And Ontario's industries will enjoy lower cost components, making them that much more competitive.

The gradual phasing out of tariffs will allow any sensitive sectors a reasonable length of time to make any adjustments that may be necessary.

The kind of adjustment that we foresee will focus on jobs in areas where markets will be enhanced by the agreement. The Government stands committed to providing whatever adjustment assistance may be necessary in sensitive sectors and regions.

Canada will retain the ability to provide assistance through training and other **adjustment programs** to our workers and industry. The Government already spends billions of dollars each year on workers' programs, including the Canadian Jobs Strategy and unemployment insurance. These will continue.

On the much-discussed issue of **dispute settlement**, we have achieved our fundamental objective. For the first time in history, Canadian exporters will have recourse to an impartial, binding, binational body when our exports are subjected to U.S. trade remedy actions.

The settlement process will now be fairer because a panel with representatives of both countries will resolve disputes. And fair dispute settlement will not only provide justice in the resolution of trade disputes, it will also discourage the initiation of frivolous or ill-founded actions.

The agreement goes one step further. Canada and the United States have agreed to negotiate new rules to govern our trading relationship. These rules would take effect by 1994, five years after the agreement takes effect.

Finally, on the emotional issue of **culture**, the Prime Minister and I have said repeatedly that Canada would preserve our right to promote and protect our cultural industries. This has been done.

Publishing, film and video, audio and video music recording, broadcasting and cable are all exempt from the agreement. This includes all production, distribution, sale and exhibition.

Let me clear up one last misconception about the agreement, one that I hear frequently on my travels throughout this province. Some people are worried that the agreement will initiate an exodus of branch plants from Canada.

This concern is totally unfounded. It does not take into account fundamental changes in the structure and operations of subsidiaries in this country over the past two decades. We are no longer talking about the so-called branch plants of the 1960s.

To survive, let alone remain competitive, subsidiaries have had to adjust to much more open domestic and international markets.

Given the fact that much of Canada-U.S. trade is already duty-free, why is it that well over 400 of the Fortune 500 companies are still investing heavily and expanding their operations in Canada?

There are many compelling reasons for these firms to be in Canada. Canada is one of the most attractive and profitable business environments in the world. We have the fastest growing and most dynamic economy in the OECD. We have an investment policy that actively promotes investment by Canadians and non-Canadians. We have a sophisticated communications and transportation infrastructure. And we have a quality of life that is second to none in terms of health, education and recreation.

That is why investors will not only stay in Canada but will continue to invest at record levels in this country.

These, then, are the facts in the free trade debate. History has clearly shown us that Canadians have adapted and prospered as we have reduced barriers to our trade. The Canada-United States Free Trade Agreement is simply the next logical step in that process.

I want to stress an important fact that is often overlooked in the debate over this agreement. This trade initiative with the United States is part of a two-track policy to expand trade opportunities with our principal trading partner, the United States, as well as with our partners under the General Agreement on Tariffs and Trade.

The agenda we have followed to liberalize trade with the United States is the same agenda we will be following in the Uruguay Round of GATT talks.

The fact that the Canada-U.S. agreement breaks ground in the new areas of trade in services, trade-related investment and agriculture will serve us very well in the current GATT Round. The fact that Canada and the United States have successfully dealt with these issues will set out a means for achieving similar progress in a multi-lateral context.

This is, therefore, a bilateral agreement with multilateral imperatives. It represents a new vision of Canada, a strong, vibrant economy with a leading role to play internationally.

What greater aspiration for those of us who love this country and believe fully in its potential. What greater demonstration of Canadian nationalism than supporting a free trade agreement that will open up new economic opportunities and help us to make the most of them.

Let me reiterate a question once asked by *The Globe and Mail*: "Who are the real nationalists in the free trade debate and who are the defenders of generalized fears?"

I ask you, what vision of this country do the free trade critics have? Myopic and insecure. They see a small Canada, a Canada without the self-confidence or dynamism to participate actively in the world economy.

Are these the real nationalists? Not to me. The real nationalists are those who believe that Canada must be bold, not self-doubting, that Canadian industry and Canadian workers can compete with the best in the world.

I believe that the free trade agreement we have achieved with the United States will help us showcase Canadian talent and Canadian potential.

As I have already mentioned, there is no province with more to gain from this agreement and more to lose without this agreement than the province of Ontario. It is as simple as that.

We are now at a kind of crossroads in our history as a trading nation. We can proceed with confidence and innovation or we can recede behind walls of fear and misgiving. I ask Canadians to judge for themselves.

Free Trade With The United States

Grant Devine

I want to thank the Institute for Research on Public Policy for the opportunity to address this group this morning. I appreciate the chance to share some thoughts with you and the rest of Canada about free trade with the United States.

What I am going to do is put together a combination of things that I will go through. I want to break it down into two parts. A little bit of history at the beginning — what we have been doing with respect to interrelationships world-wide, particularly associated with trade, and then I want to talk about what the world looks like today and review the impact of a free trade agreement on Canadians, on a province like Ontario, on a province like Saskatchewan and the impact it might have world-wide.

Let me start by reviewing the objectives of the free trade agreement. You are all familiar with them. But just so that they are on the record, because I think it is important that we note them, they are: a) to eliminate barriers to trade in goods and services between the territories of the two parties; b) to facilitate conditions of fair competition within a free trade area; c) to significantly expand liberalization of conditions for investment within the area; d) to establish effective procedures for the joint administration of an agreement and the resolution of disputes; and e) to lay the foundation for further bilateral and multilateral cooperation to expand and enhance the benefits of the agreement.

On tariffs, the United States and Canada agree that all bilateral tariffs on goods meeting the rules of the country of origin will be eliminated. That's the objective of a free trade agreement. It seems to me that most academics and most people who looked at those objectives, would think they are relatively honourable and that they are intended to do good.

Now in that context, I think it is important to back up and find out where in fact we might not have been doing as well in the past.

Let me start, first of all, in 1929. We had a stock market crash followed by two interesting events. The first was a very aggressive protectionist attitude and measures in the United States. In 1930 the Smoot-Hawley Tariff Act was passed. It doubled tariffs and led to world-wide retaliation.

The result was that world trade almost ground to a halt. From 1929 to 1933, United States' imports dropped 70 per cent from \$4.4 billion to \$1.4 billion and exports dropped 70 per cent from \$5.2 billion to \$1.6 billion. There was massive unemployment across the United States and Canada and a good part of the free world.

So history would teach us the two things that we may not or should not do during a crash of the market: the first is to raise interest rates and the second would be to raise tariffs or to raise economic sanctions against each other.

Clearly today we have the choices before us. I think history will have its impact and its influence on policy makers on both sides of the border.

Following economic sanctions and the Depression, we had a world war, and more barriers to trade and more economic sanctions were applied. European countries deliberately annihilated each other's economic infrastructures, blowing up ports and railroads and bridges and roads and communication systems. The whole intent of this was to stop trade, increase the tariffs and apply sanctions to each other. And to do what? To weaken the other guy. And it worked. It weakened a lot of countries in the world. I guess you can say we won the war but the world lost.

Since the Second World War we have been doing some other things. Canada and the United States, the Europeans and the Japanese gradually reduced economic sanctions and trade barriers against each other. The first GATT Round was in 1947. The Kennedy Round was 1963-68 and the Tokyo Round was 1973-79, and we have been going in the other direction liberalizing the trading relationship and removing sanctions and removing the barriers to trade.

I am advised that in 1967, 60 per cent of all the goods traded between the United States and Canada were duty-free. In 1987 about 70 per cent of all the goods traded between the two countries were duty-free and the intention is by 1999, 100 per cent of all the goods traded between the two countries will be duty-free.

So we have been at this for some time. The average tariff on goods where duty applied was 15 per cent during the Tokyo Round and it is now down to 10 per cent today.

So from a world vantage point since the Second World War, we have been on track, gradually reducing the tariffs between the two countries and between the major trading partners of the world.

It seems to me, historically, the bilateral tariff reduction between countries, and particularly between our two countries, fits the multi-lateral trade reduction pattern. It is a good example. It is consistent with what makes good sense — sound economic sense — for the world's largest trading partners to be doing this and to be leading by example.

And we've won by it in the sense that we have grown rapidly, have seen major economic development take place and the standard of living improved. I think, historically, we can look back and say we have made progress since 1929.

There are two things to note today. First, I think we have to look at current events and what's happening as we speak here this morning. Second, we have to look at what's happening in a world-wide sense. What I am referring to are the interconnections and the interdependencies world-wide of a global village.

Recently we have seen trade and financial deficits, increases in protectionism and we have experienced a stock market crash.

We have choices right now and history says that we can go either way. We can raise interest rates and we can raise trade barriers. But I think most people would agree that we should reduce interest rates to allow consumers to continue to spend and, for heaven's sake, we should not increase barriers to trade if we want to move out of a recession.

In the history of the world, if you want to slow a country down, you don't trade with them — you apply sanctions, you hurt them. So you have to ask yourself during a recession or any other time, why would you want ever to put sanctions on yourself if that's what you use to hurt others?

It seems to me that if you were looking at the Toronto market and the housing markets these days, very expensive houses are on the market and people are worried whether in fact there are going to be buyers. I am not so sure closing the borders or restricting trade would help the housing market. I think it would be the opposite. That's a local example.

Well in any event, we have had a stock market crash. We have been through this before. You know what to do with interest rates and you certainly know what happens if you do certain things with respect to trade between two countries or world-wide.

The second thing that we have to look at today that is different from 50 years ago is a world-wide interdependence. We are con-

nected. And to be responsible and successful, Canada must harness rapid change.

Multinational management is necessary for success and survival. The only thing that is going to be constant is change, and it is getting more rapid.

Our very existence in the long run is linked to others. It obviously is with respect to whether we are going to have a peaceful existence with each other at this time of nuclear power. Our food, our income, our retirement, our environment, our jobs, our security are all linked to world partners. So for long-run co-existence, we need to set examples of thoughtful progress, of how to deal with each other.

It seems to me that trade liberalization is good for the world during these times when we are connected and linked so intimately. So, from a world vantage point, bilateral free trade is healthy. It's good, it's peaceful and it's responsible, for today and for success in the future.

Well what about for Canada? Historically, more trade with the United States, and anyone else for that matter, has meant more jobs, more income, more economic growth and a higher standard of living — you know all the figures. We do about \$150 billion in two-way trade between the United States and Canada. We trade big with Japan, the Soviet Union and China. The Wheat Board markets all over the world, and we market potash, oil and uranium world-wide. Ontario is a big trader, one of the biggest in the world. Saskatchewan trades for a living, Canadians trade. We are well respected for quality, integrity and continuity of supply. We are liked and trusted. When we say we are going to deliver Canadian wheat or bacon, or potash of certain quality, it's delivered. We have a world-wide reputation.

So for Canada the role is to set an example because the world looks to us for examples. Why not Canadians? We are fairly well educated, aggressive and we trade for a living.

During a time of stress, you are tested. And right now we see, for example, the stress in the United States is toward protectionism. And really you have three choices when you look at it. If the United States is in an ugly mood and they want to apply sanctions to other countries and to themselves, trade barriers and tariffs to hurt us, you have three choices. One, you can just let them do it and leave them alone. It hurts particularly when they have legislation pending like the omnibus trade bill. Two, you can try to convince them and Canadians to change all our laws immediately. That's not likely. It takes us a long time to change laws, certainly laws that we have had on the books for some time like countervail and anti-dumping laws.

Politically it is impossible to get Americans, let alone Canadians, to change their laws immediately. So you can't do that. But third, you can bind them and set up a mechanism to manage change and steer economics in the right direction. Harmonize the laws over time, contain them.

Now if you had the three choices — leave it alone, or try to change everything immediately, or get hold of it and set up a mechanism to begin to direct it where you want — I don't believe there is a choice. The third alternative is this world of interdependence is rational; it's logical. Get hold of it.

Well then, there really is only one choice, in my view, that makes sense for Canada, for the United States and indeed, for the world.

There is no question about rapid change. We just have to harness it or we will be either run over or left behind.

Let me put it another way. There will be economic adjustments in this information-based, high-tech global economy with or without tariffs. With or without tariffs, there are going to be rapid economic adjustments. So the question is, which way is the adjustment made more rational, logical and predictable and less shocking to us? With a tariff world or a tariff-free world?

When I am on campuses I talk about free trade in knowledge. Students like it. They are aggressive. They like to learn from other countries. They like to learn other languages. They want to travel. They are aware of the things that are happening internationally. I ask them: "Do you think it would be a good idea to have free trade in knowledge?" And they say, "Right on."

We are in an information-based economy, world-wide. And if you have knowledge and access to knowledge, it allows you to prepare for change in an incremental fashion. Prepare for change because you are aware. Nobody can put blinders on and expect to adjust to change except in severe shocks.

Canada has adjusted to the last 50 years very well. And with more and more intimate knowledge of economic interdependence of world trading partners, it will adjust well in the future. If we hide or restrict our knowledge about others and about ourselves because we are afraid in an information-based, high-tech world, we will be behind. And we will run the risk of greater adjustments and larger shocks than if we were better informed.

When I look at research polls, and some politicians look at polls, I find that about half of the population supports a free trade arrangement with the United States.

But what's very interesting is that it is higher than that among the youth, the young people. They seem to be more comfortable with high tech, more comfortable with computers, more comfortable with

an information-driven lifestyle. Kids are not intimidated by computers whether they are seven years old or teenagers or at university. They are not afraid of them, it's easy for them, they are comfortable.

And young people today seem to be a little more closely tuned in to what's going on in the world than when some of us were young, maybe 20 or 30 years ago. They are very tuned in to the environmental interconnections and those associated with peace — more so than we are.

So, I believe that a bilateral trade agreement that lowers tariffs between two countries is good for the world. Second, I believe that it's good for Canada. And increasingly, I believe that people are going to appreciate that.

Let me turn to Ontario and Saskatchewan as a couple of examples where I think that there will be some benefit. Let me start with Ontario.

As part of the world and part of Canada, the industrial heartland of a country like Canada will for several reasons benefit the most economically in the short run from lower tariffs.

First of all, Ontario is large enough and developed enough to have the economies of scale to allow it to take advantage of a big market. It doesn't have to go back and build the infrastructure because it is already there in many cases. Certainly much more so than in the province of Saskatchewan. So if you have been given access to 230 million people and you have economies of scale now, you can just slip right into it relatively fast, compared to other places. So a quick benefit and a more immediate benefit goes to those areas that have been industrialized, like Ontario.

The second benefit will be investment. It will first of all take place where you have industrialization. I believe this is relatively accurate.

General Motors has invested about \$4.8 billion in the Oshawa area since 1980. General Motors has invested about \$2 billion in the last two years in the Oshawa area. Investment because you have the infrastructure there and access to the market. And the economies of scale are such, because of industrialization, that you can see immediate benefit. So it attracts money. What does that do?

That builds jobs. I don't know how many tens of thousands of new jobs are created by \$4.8 billion invested since 1980 in one small area of Canada, but it must be substantial. Tens of thousands at least.

So the immediate benefits are: 1) access to that market which you can respond to; 2) investment because you have the infrastructure; and 3) the jobs that go with it right now.

Obviously then, you have a large consuming population that will get the benefits of lower costs. I am sure you have had people describe the benefits of no tariffs in terms of costs.

Your standard of living improves because you can buy things on a global or a North American market basis. Most of the people in the country live in the industrial heartland; they will receive the benefit quickly.

And finally, the critical mass of information-based and technological-based infrastructures is already here and the financial centres are here. There is a benefit immediately and the long-run strength can be levered as you move world-wide.

I would be excited about fewer tariffs if I lived in Ontario. It means more money, more jobs, growth, expansion, investment and a higher standard of living. Incidentally, Ontario now trades more with the United States than most countries do.

What about Saskatchewan? Saskatchewan will benefit more in the long run. What Saskatchewan wants, and provinces like Saskatchewan want, is the opportunity to grow. The opportunity. If we have access to markets, we can trade immediately where we have cost advantages, particularly in resources. Resources will move into the United States; we can increase our income and, as we increase our income, we can put more money into value-added, processing and manufacturing, and we will begin to have growth. But it takes longer because we are more resource-based as opposed to being developed already.

The advantages to having access to the U.S. market for resources is income. We can have income and we can invest. Lower costs will help us manufacture and process. So tariff-free reductions and the removal of some of the old freight rate problems will help us grow because we will have access to the input at cost in a North American context. It takes time, but we will have access.

Last, there will be a change with respect to attitude. That is, we are on the new frontier, everything is possible, we can go for it and that will be very powerful.

So in summary, Saskatchewan can compete immediately in the resource sector. The lower costs will help us take advantage of things that we can build in the future. We will take longer than Ontario to lower the cost curve in manufacturing; that's true, but we will have the opportunity.

We will be able, in the long run, to do the kinds of things that we have seen in other parts of North America and the world in terms of industrialization.

Well, let me summarize what I see happening today. Adjustment will take place with or without tariffs. I believe adjustment is easier without them and history would support that. So what are we facing here today? Well I think we are facing some economic decisions.

Support for the whole question of free trade is good enough in Canada. It's about 50 per cent. It's growing, I believe, as we understand it.

Look at co-ops today. Look at the Wheat Pool. They understand the value of trade. Wheat Pool members support me on trade. Not every one of them, but a large number of them from a large co-op that is rural-based support trade. Retailers, co-op stores and consumers know the benefits.

Where are the other routes? Rural people. Whether they are in potash, in hogs, in beef, in wheat, in timber, in uranium, or in coal, rural people who trade for a living support fewer tariffs so they can do business.

So if you can get reasonable support from co-ops, producers and consumers and retailers alike, and reasonable support from rural people, what does that leave you in terms of those opposed? Some political parties. Union leadership. And I separate out the membership from the leadership. I think that's fair.

I look at some of the questions that they ask. "Well, gosh, darn, what about our sovereignty?" Well, what about it? I mean if you look at the Europeans, they have been together in an economic trade package for some time and the French are still French and the Germans are still German. Socialist Greece didn't want to join and finally they decided to, and it's going to take a long time to change Greek culture. They aren't afraid of it. Australia and New Zealand are on their second trade pact. They understand it. Has Japan lost its culture by being in every single country in the world where they can make money? All over the world Japanese culture is stronger now than it has ever been.

"Well, too much investment could hurt the country." That's another argument from some union leaders. Let me put it this way: I don't want any more investment than you have in Oshawa. If I can just have that much in Saskatchewan. No more than the Member of Parliament for Oshawa has.

Tens of thousands of jobs and billions of dollars. It's fine for somebody who has that to say investment would hurt. I just want my share. I don't buy the argument that investment would hurt the country.

"Well, we have to vote on it." That is the next argument. Well we will — you bet your life that we will vote on it. Probably for elections to come.

But I don't think that voting is the safety net. Whether you are up or down in the polls, I believe that in some cases you have to ask

yourself: "Is it right to do something?" If we had a vote on Meech Lake we would have never done it. Meech Lake is good. Now those that were against it, they say it's past, it's over. Controversial, but good. We didn't vote on it in the country, but we did it. The same applies to this.

The individual running around the country supporting a vote on this makes centerfold in newspapers. But when he is asked: "Well, when you pulled your union out of the international union, why didn't you have a vote?", He says: "If you thought we should not proceed without a referendum vote of that entire membership — I couldn't let that happen. If I went out to the locals, opening the doors for corporate interference and internal politics and personality clashes, by the time we counted the votes, the union would be split into pieces." I think that speaks for itself.

"Well, if we opened up the borders it would weaken us", is another argument. Historically, I can only say that sanctions weaken you when you apply them to other countries or when you apply them to yourself.

There is no economic evidence anywhere that indicates that by putting up tariffs, you are going to strengthen yourself. It just isn't there. Why would you want to put sanctions on yourself? When you are at war with people, you do the exact opposite. You blow up their bridges and blow up their communication systems so they can't do business. We have been talking about it today in terms of countries in Africa.

The next argument is that we would have to adjust. Well, I believe tariff-free economic activity will result in fewer adjustments in things that we have already adjusted to. Twenty per cent interest rates, \$2.00 wheat, \$10.00 oil and the stock market crash. Do you think we don't adjust? We adjust every day. Ask the oil industry in the West. Ask the wheat farmer in Saskatchewan. Ask others if we haven't adjusted. There's been massive adjustment. We have adjustment regardless of whether we have tariffs or not. The question is, would it be better to have no tariffs or more tariffs? There is no justification for more because it hides the information that is necessary for incremental change.

Well, another argument is that we are not big enough. "My gosh, some other countries are so big that we won't be able to handle it."

And my argument is, Ontario is big enough alone to make a free trade agreement with the United States. Ontario alone! It does \$90 billion in two-way trade, for heaven's sake. There isn't a country in the world that wouldn't give its eye teeth for open access to the U.S. market with a binding dispute settlement mechanism.

Would you think any country in Africa would like access to the U.S. market? Certainly they would. Ask them. But are we big enough? Ontario is big enough, let alone Canada.

Some have argued in our Legislature that it would tie the hands of Canada during a recession or during a protectionist time because we would be linked to the United States. Tariff-free just means you have free opportunity.

Now, if the United States is turning protectionist, and we are exempt, is that good or bad? It's good! If they slap tariffs on Japan, where will Japan do business? They will tend to come here. The argument is that, well, Great Britain when they joined the economic community, the European communities, they quit doing business with us and did more with Europe. Well sure, because it made them money. You go where you have the opportunity. Reduction in tariffs gives you the opportunity. You can either say yes or no. Nobody is forcing you to trade with them. But you are exempt from the difficult things they may impose on others.

Some would say that this agreement is not perfect. Right. Neither is Meech Lake. Neither are you; neither am I. But it is a giant step forward. Better than the other two alternatives: leaving it alone, or trying to change all the laws all at the same time. That's impossible.

Finally let me say I believe that it's time we really looked at the truth from an historic point of view on economic development and trade and tariffs.

It certainly is time to do what makes sense. It is time to do what is right. Maybe 50 per cent of the people don't agree with it yet. But that doesn't mean that it's wrong.

A free trade agreement is not easy, but I believe it would be right historically and right for the future. I believe that we are mature and sophisticated enough to lead and not simply follow our fellow members of the global family. I am confident that Canadians will rise to the challenge.

Discussion

Robert Stanfield

Robert Stanfield:

Thank you very much, Premier Devine, for a very vigorous, pointed explanation of your position with regard to free trade. Premier Devine is prepared to take some questions for a few moments if there are some questions arising out of his talk or from somewhere else.

Daniel Roseman:

For those who have been supportive of the trade negotiations with the United States, one of the hopes had been also to address the interprovincial barriers to trade. I'm wondering how you view the outcome of the negotiations for addressing those interprovincial barriers, and whether it is politically feasible to try to start a process for eliminating those, even though we don't have an agreement that deals in detail with a lot of provincial areas of jurisdiction.

Premier Devine:

All the premiers have agreed that there are too many provincial barriers and that we should open up interprovincial trade. There's no disagreement with that objective. How fast you do it, and how rapidly in which industries, are more difficult questions. We mentioned an

example this morning — Moosehead beer. I can't drink it in Saskatchewan or Ontario, but I can get it in Florida, Texas and Chicago. We can't trade beer among the provinces. But I believe we will reduce the barriers over time. The free trade arrangement will not hurt that; it will probably give some more momentum to provincial cooperation, but I believe it will happen regardless.

David Leyton-Brown:

I'd like to ask you what the response with regards to the potash issue is going to be in light of the free trade agreement. Will it have any impact under the standstill provisions or anything else, and where does the Government of Saskatchewan see the potash issue going now?

Premier Devine:

First, let me say that if you sign an absolutely perfect free trade agreement, that both sides agree to, that's academically perfect, one thing for sure is that you can't cheat. You have to play by the rules, if you expect to have access to each other's markets. Therefore you have countervailing and anti-dumping provisions of some kind or other. Our anti-dumping laws are very similar to American anti-dumping laws. And they're there to protect you from somebody who is not playing by the rules of the game.

The cases that are before the courts, or before the regulatory authorities are tied to somebody's interpretation that you have not been playing fairly. In the potash case we have a very unfair anti-dumping constructed cost ruling. It's constructed cost — that means that somebody can sit there and dream up margins of dumping by Saskatchewan producers. Very unpopular in Saskatchewan, and extremely unpopular in the United States. Three and a half million corn producers — we supply 80 per cent of the potash in that country — are upset about this proceeding. Two mines in New Mexico that couldn't provide 8 per cent of the entire market took the case and accused us of dumping. Politically, there is tremendous pressure on the Americans to change that. Whether it will happen quickly or not is hard to say. Those that brought the case forward could terminate it and withdraw. They might do that. The Commerce Department has made an interim decision and there will be a final determination in January. They have postponed their final ruling which is a good sign.

The potash case is a very unsatisfactory ruling and appears more unsatisfactory in light of the trade agreement. It doesn't look right to Americans; it doesn't look right to Canadians; everybody loses. So, I believe that the initial trade agreement will help us in cases like potash in terms of the political climate right now and then from a technical point of view when the agreement comes into effect. Even if the agreement doesn't help immediately, you have a new mechanism to review it and a basis to conclude. "This law is pretty stupid, let's harmonize these trade laws, let's get these into something that is more market sensitive." Sensible trade laws would consider consumers, for example, as well as producers, and the U.S. law doesn't do that now.

V
*Economic Regional
and Labour Market Adjustment
Implications*



Canadian Federation of Labour Perspective On The Trade Debate

James A. McCambly

I would like to thank you for the opportunity to be with you today and to give you the Canadian Federation of Labour perspective on the trade debate.

The Canadian Federation of Labour is the only labour group that has been participating in the International Trade Advisory Committee and the Sectoral Advisory Committee. It has been a very interesting and educational exercise.

The Executive Council of the Canadian Federation of Labour has reviewed the Preliminary Transcript of the bilateral agreement. The deal is complex and the final wording will not be available for a further six weeks or so. The Executive Council therefore concluded that it would be premature and unproductive to take an overall position for or against this agreement at this time.

It is unfortunate that the nature of the current debate is so polarized. It is clear that some labour groups and some politicians have long been committed to oppose any deal, even if it was a good deal. It is also clear that some business groups, provincial governments and the Conservative government in Ottawa were committed to support any memorandum of agreement tabled, regardless of its weaknesses. I would hope that Canadians would pull back from this current polarized, emotional debate. There is a lot on the table that needs to be considered very carefully.

We will not take a position on the agreement until at least December after the final wording is available. I am also confident we will oppose the move if the governments do not put in place major adjustment support programs and policies both to gear up for the larger markets and to provide positive assurance for displaced workers. I will return to this in more detail later.

It is forums such as this that can give Canadians a neutral, technical assessment of the deal. I am therefore extremely pleased to be here today to discuss these technicalities.

One year ago, the Canadian Federation of Labour publicly stated that there are 11 basic elements that had to be dealt with in a bilateral agreement. I would like to comment on some of them as they relate to the memorandum of agreement, and to elaborate on others.

For example, we said that social programs were not negotiable, and they were not. Our ability to support regional development remains intact as it was subject to the new subsidy code. But certainly, the North-South flows will be strengthened and the East-West links might change. We should not ignore that the Maritimes are, for example, considerably closer to the U.S. markets than is Japan.

We said that there should be an adequate transition period and transition provisions. Five to 10 years should be adequate and the opportunity for a three-year extension to tariffs where injury occurs. I think we might consider that to be an asymmetrical adjustment in our favour.

We said there should be a binding international disputes resolution mechanism that would operate under a new bilaterally defined subsidy code. It is clear that the procedure does not meet our expectations for a bilateral binding disputes board that would supersede the right of parties to invoke countervail. However, we must recognize, and I am sure Mr. Reisman can confirm, that there was another party at the bargaining table with other ideas.

So there is a new partially binding mechanism. I understand that this is an international first. But it is incomplete. It is not binding in all areas. It does not cover the area of non-tariff barriers (e.g. harassment of the high technology sectors, process barriers, and other issues covered in section 337 of the U.S. Trade Bill).

There is a provision for creation of a new industrial subsidy code. We would like to see this in place so we could know what is acceptable and what is not. We must wait five to seven years to see if, in fact, we can achieve agreements on what constitutes fair trade. This is complex and I recognize the difficulties, but if goodwill prevails, such a code would be invaluable in stabilizing trade relations.

Safeguards

There is major success in the area of safeguards or actions under article XIX of GATT. Both Canada and the U.S. have agreed to exempt the other from the so-called "sideswipe provision". This is a

major benefit to Canada, particularly in the area of steel. It may also help other areas where the U.S. might invoke general protection actions in the future.

Services

The services and telecommunications sections are not yet public, so I cannot comment on them. Increased competition in the banking area may well be beneficial.

Procurement

Bi-national provisions waiving their procurement provisions do not go as far as I would like, but there is provision for expansion. The U.S. procurement market is 10 times that of Canada. But Canada has not gained assured access to key sectors such as urban transit equipment.

The defence industries procurement program remains in force. If implemented as stated, the procurement area may prove of significant benefit to Canada, especially for smaller and medium-sized high technology companies.

Tariffs

The draft agreement gives Canada tariff-free, preferred access to the U.S. market, particularly in areas of higher value-added. Although this applies both to resources and finished goods, it is finished products that have had the higher tariffs.

The Canadian Federation of Labour has previously noted that if the present balance of trade is measured in terms of value-added and jobs, the balance is tipped heavily in favour of the U.S. They buy more resources from Canada. We buy more finished goods from them. The agreement will give us the opportunity to redress that balance and create Canadian jobs in Canada if we are able and ready to move. This could allow Canada to change its basic economic structure toward a higher-technology, finished-product economy and secure more employment. However, if Canadian business is not prepared to gear up to world-class standards, the opportunity will be lost, no matter how good this deal may be.

These are some of the important things we achieved. Now for my concerns. They fall into three major areas: energy, investment, and adjustment.

Energy

The document outlines an energy agreement to provide for "secure access to the U.S. market in return for non-discriminatory U.S. access to Canadian energy supplies". Under the investment section, the agreement binds both parties not to adopt policies requiring minimum levels of equity holdings by their respective citizens. That is why the section on energy gives me considerable cause for concern. It goes far beyond an elimination of tariff policy. It is a sharing of Canadian non-renewable energy resources. Renewable resources such as hydro power are no problem, but the non-renewable area appears to say that what you have is yours and what we have, we will share. I don't feel comfortable in committing future generations of Canadians to sharing non-renewable resources on a proportional basis with a country that has 10 times our population.

When it comes to Canada sharing the resources of the Northshore of Alaska, there is no mention of natural gas, and the oil is capped at 50,000 barrels a day. That eliminates the possibility of building a pipeline because the oil must be transported from Alaska on U.S.-flag vessels.

"Proportional access" may mean the right to purchase in a constant contracted proportion. If it means sharing the entire resource, it is quite another matter. It is not clear whether existing Canadian ownership policies, especially in the resource and energy sectors, remain intact. The fine print of the combined energy/investment sector provisions, when they become public, require the most careful scrutiny.

If the basic deal is that the U.S. has the preferred right to purchase and assurance of supply to Canadian energy by contracted agreement in return for increased market access for Canadian finished goods, then the agreement has the elements of a fair deal.

If the basic deal is total unfettered access and ownership by foreign multinationals of Canadian energy, and at the expense of Canadian energy, then the agreement is not satisfactory.

The Canadian Federation of Labour will carefully examine the fine print on this issue. I would call today on the government to make public all the information on it, as soon as possible.

Investment

With regard to investment, an investor's dollar is still a dollar in Canada whether it comes from Europe, Hong Kong or the United States. Generally, investments should be welcome and treated the

same as domestic investments. However, this agreement gives virtual *carte blanche* to U.S. investors to do as they please, only subject to existing laws, regulations and published policies and practices. The agreement also states in the investment section that "existing laws, regulations and published policies not in accordance with the uses described above will be grandfathered". I am not sure what policies still exist that might be useful, but it is certain that they are far fewer than they were just a few years ago. National treatment covers most the areas with regard to the conduct of a business, but the agreement goes on to prohibit minimum levels of Canadian equity and allows for free transfer of profits.

Three problems that come to mind are:

- How do we maintain the branch plant benefits in Canada derived from government assistance to research and development for new products and for world mandates?
- How do we ensure that, as in the past, foreign joint ventures with Canadian firms will be undertaken to improve Canadian expertise when undertaking major Canadian projects?
- How do we ensure, as has been the problem in the past, that foreign holders of Canadian resources will develop those resources rather than sitting on them, when others are prepared to develop them?

The Canadian Federation of Labour believes that the key issue, outside the resource sectors, is the behaviour of capital in Canada and not so much the question of ownership. We must have control of the performance and practices of multinationals that invest in Canada to the same extent that we have control over domestic investors. Foreign ownership cannot have special exemption.

The Canadian Federation of Labour believes that the social conduct of capital in Canada (by both Canadian and foreign firms) must be controlled by Canadians. The unfettered right of capital to export profits freely rather than to reinvest them in Canada, to substitute freely capital for labour, to treat Canadians as a totally disposable factor of production in the interests of absentee shareholders, and to dump people and communities onto welfare is no longer socially acceptable in this country.

The phenomena of the "hollow corporation" and the shift of production lines offshore have cost the U.S. dearly in terms of their trade deficit and in terms of employment; in my view, they have caused much of the current protectionist pressures in Congress.

The Canadian Federation of Labour therefore suggests that a new binding corporate social code of conduct be developed and that this be reflected in all framework legislation. It is important to note that the investment chapter concludes that investors will have enforce-

ment recourse to both the dispute resolution mechanisms and the U.S. and Canadian courts. We have to be clear on the fine print of national treatment.

Adjustment

My last issue has to do with the adjustment question. The Canadian Federation of Labour has been on record for the last year that the signing of a new trade arrangement must be accompanied by a government-sponsored adjustment package designed with two objectives in mind:

- a) to allow Canadian businesses to gear up to a market 10 times the size, to take advantage of all possible job creation and combat increased import competition;
- b) to ensure the brunt of the costs of adjustment will not fall on working Canadians.

We have stated that loan guarantees should be made available to help companies that are prepared to gear up to increased competition, increased production and new markets. We have stated that management must be upgraded to full international competitive and marketing standards. We have called for non-confrontational planning for change by expanding the labour management industrial adjustment service program. R&D and new product development expenditures in Canada must be increased by some \$3 billion a year just to stay even with the U.S. We have stated that all severance pay should always be tax deductible, and not taken into account in unemployment insurance entitlements. And we've said that the waiting period requirement on UI before eligibility for retraining should be abolished.

We have stated that pension and other fringe benefits should be portable. We have called for a national early retirement program for workers reaching retirement who cannot make the transition to new employment. We have stated that current bankruptcy provisions are inadequate. We contend that multinationals, and not the taxpayer, should be required to compensate Canadian workers fully in the event of North American plant rationalization and closures. We have argued that the current tax reform proposals are not designed to move Canada toward the higher technology and job value-added society needed to compete in larger markets. There is a need to ensure that workers inadvertently affected by the trade initiative would be adequately compensated and assisted.

Periodically we hear an archaic piece of conventional wisdom — that existing adjustment programs are adequate, and no special

adjustment assistance is required. We have looked into this, and they are not adequate.

There is no clear message from government. Mr. Mulroney says, "Whatever adjustment package is needed, we will have it." Mr. Wilson says, "We do not expect there will be a need for any significant programs of adjustment."

The current adjustment levers are not adequate. If there is to be a comprehensive trade deal, a comprehensive adjustment package is essential. If a major trade package is good for the nation, then the nation must ensure that workers who may be displaced do not suffer.

There was a major adjustment package at the time of the Auto Pact. The Macdonald Commission called for an annual \$4 billion a year labour adjustment package on the free trade issue. I do not believe workers in a small country can take a blind leap of faith into a pool where we do not know the temperature of the water, how deep it is or, in fact, if there is any water. Workers' interests must be ensured.

If the main benefits go to the multinationals and get shipped out of this country, if Canadian companies do not gear up and if there are additional costs and no economic benefits to the average Canadian, then this deal is not acceptable.

Today I would like to say that if there is no serious industrial and labour adjustment package, including a major overhaul of the Canadian framework policies to gear up this country, we will be the losers. We have to gear up for a new age of opportunities. If we don't do that, I don't think it matters whether it's a good agreement or not.

I wish to state unequivocally today that the Canadian Federation of Labour will therefore not support any deal if the benefits to big business and social costs have to be borne by those that can least afford them. We must have a clear-cut adjustment program.

To sum up my remarks, a review of the preliminary text suggests that there are some major advantages to Canada in tariff-free access to the U.S. market, in safeguards, in procurement, and with the potentials of levelling the playing field with the U.S., in terms of value-added jobs in technology.

If the price of the deal is long-term U.S. ownership of all Canadian resources and loss of economic sovereignty with most of the benefits going to the multinationals, then that price is too high. Clarification of the final text and its application are needed on the disputes procedures, energy and investment.

But, even if it is a fair deal, there must be a major adjustment package, as outlined, and we must gear up as a nation to become a higher-technology society. We must stand on our own two feet, both bilaterally and multilaterally.

So, let's see the fine print, and not just some of it. Let us reject the deal if it is bad; let us improve it if it's half good; let us accept it if it's good. But let us in any event gear up properly for the next century.

Adjustment Concerns During the Transition to North American Free Trade

Rodrigue Tremblay

Let me say at the beginning that I am very much in favour of the draft agreement for a North American free trade zone. I've been arguing in favour of that agreement, or of a similar agreement, for the last 20 years, and I'm not here therefore to criticize the substance of the agreement. I've been asked, however, to talk about the adjustment process that should accompany the agreement's implementation.

Generally speaking, politicians are reluctant to talk about the adjustment process because they do not want to be alarmists and create the impression that there will be a lot of dislocation if a free trade agreement is implemented.

When Donald Macdonald said that people in Canada should take a "leap of faith", he meant of course that, after the end of the exercise, the result is going to be good for the Canadian people, for Canadian workers, for Canadian firms, and for Canadian industry. It is my feeling, however, that the "leap" means that between here and there, there will be a dynamic process of adjustment and that many things can happen during an adjustment lasting for 12 or 15 years. Compared to the United States, Canadian industries and Canadian regions will bear the brunt of industrial organization for a continental market. Therefore, the adjustment process will be more important in Canada — it will be crucial if the potential gains from opening the two markets are going to be translated into *real* benefits. No theoretical model can be complete enough to take into consideration all contingencies. Given the relative immobility of labour in Canada, inter-regional and inter-industrial adjustment would have to be monitored closely. And given the overall objective of moving to a more optimum size, to more specialization and to more exports to the United States, intra-firm adjustment will have to take place during the adjustment process.

We should be worried if these adjustments do not take place. The productivity, output and employment scenarios can be tilted toward the less optimistic outcomes, with less growth in GNP, less growth in productivity and less growth in employment, especially in the manufacturing sector, compared to the primary sectors and the service sector. The resource-based industries and the regions that are resource-based would fare well in a continental market. But for the footloose manufacturing sector, there should be concerns about the adjustment process, given certain structural characteristics of regions and industries — for example, access to finance and capital, the export orientation, and the foreign ownership exposure of each industry and of each region. Therefore, the basic question should be: What is the adjustment mechanism that should be established to make sure that Canadian industry comes out stronger and richer at the end?

Let us see, first, what is — or is not — in the agreement regarding the adjustment process. Second, what should governments (federal and provincial) do during this adjustment process?

First, the agreement is somewhat deficient regarding the adjustment process, especially from a Canadian point of view. It seems that there was no time or will to accommodate the specific Canadian needs during the adjustment process. The adjustment question seems to have been an orphan during the negotiations and even far from governments' preoccupation. I think it is doubly a mistake. It is a mistake economically; since the sum of gains is going to be larger than the sum of losses, there should be compensation to losing parties. It is also a tactical error politically to dismiss the losers' fears regarding the adjustment they will have to go through.

For one thing, tariffs are going to be removed at the same speed for both countries, even though Canadian tariffs are twice the levels of U.S. tariffs. Many Canadian economists proposed that Canadian tariffs should have been removed at a slower pace in order to take into consideration the adjustments that Canadian firms will have to go through.

More dangerous, in my view, is the substantial disarmament of Canada regarding the possibility of strategic take-overs of medium-sized Canadian firms by larger U.S. firms during the adjustment process. After three years, the review of foreign take-overs of Canadian firms will go from a threshold of \$5 million of assets to \$150 million. I would have preferred that the \$150 million threshold take effect at the end of the adjustment process, and not after three years, as it is in the agreement.

Another weakness of the agreement during the transition period is the different impact on Canadian industries than on U.S. indus-

tries if the agreement were to be terminated for cause. The 60 days and 6 months provisions for abrogation (60 days for changes to domestic laws, and 6 months for the failure to devise mutually accepted rules) can be a boomerang for Canada in the sense that such short-term termination notices place Canadian industry at a distinct disadvantage.

Indeed, Canadian industries cannot rationalize and specialize for a large continental market and, at the same time, have the sword of Damocles raised so high that things can change dramatically in 60 days or even in 180 days. As Simon Reisman said yesterday, the final text may include a longer notification period for abrogation than the six months contained in the U.S. laws. Canada should have — or should negotiate — a period much longer for the termination of the agreement, a period like three years, for example, or adequate compensations if a country were to abrogate the treaty unilaterally, without cause. Of course, it would have to be symmetrical. But the likelihood that the United States would abrogate the agreement is higher than the likelihood that Canada would abrogate. The only experience that we have historically is the abrogation that the U.S. carried out in respect of the Reciprocity Treaty in 1866, after one year's notification.

Second, let us go to the question of what the role of governments should be during the adjustment process. Theoretically, since the shift in trade policy is not a random phenomenon but is the largest shift in policy since Sir John A. Macdonald's National Policy of 1879, it will create winners and losers. However, the net effect is expected to be positive in terms of creating wealth. Therefore, governments have a responsibility to act as arbiters and to compensate the losers — especially the trade-displaced workers — during the adjustment period. Inasmuch as the adjustment is inter-industry and inter-regional, it is a clear responsibility of the federal government. The precedent in Canada is the Transitional Assistance Benefits Program that was established by the federal government after the Auto Pact of 1965. Three thousand workers benefited from the program from 1965 to 1976.

Of course, it is not easy to distinguish between cyclical macro-economic adjustments and trade-displacement adjustments. My own feeling is that the federal government should negotiate with the provincial governments, especially Quebec and Ontario, a program of transitional adjustment for trade-displaced workers in order to assist the workers that need recycling or retraining. More generally, I believe that provincial governments as such will have to play an active role during the adjustment period in order to facilitate the industrial reorganization that will be required to obtain the expected industrial

benefits from the free trade agreement. In particular, the availability of finance for medium and small-sized firms to modernize and rationalize will be paramount. Provincial governments may be in a better position than the federal government to provide assistance in that regard. In any case, they should monitor closely to see if firms move fast enough to face the increased competition and take advantage of the new export potential open to them.

Another key indicator to watch during the adjustment period would be the effective exchange rate of the Canadian dollar. I've estimated that the Canadian dollar depreciated in real terms by about 10 per cent from 1973 to 1986. The Canadian dollar has a tendency to go down when there is an international slow-down; when there is an international boom, it tends to go up. It was very much up in the early part of the 1970s, and it is low in the 1980s just as the Australian dollar is relatively low for the same reasons. When Canadian and U.S. trade barriers are removed from 1989 to 1998, the Canadian dollar should depreciate — all things being equal — provided that Canadian trade barriers are higher than those of the United States. For tariffs, this is the case; but in terms of non-tariff barriers, this is not clear.

Of course, things may not be equal, and we should be prepared to face a contingency regarding an appreciation — a real appreciation — in the Canadian dollar. What if capital inflows or a rise in the price of resources and primary products were to appreciate substantially the Canadian dollar in real terms? Then, the Canadian manufacturing sector would get a double whammy. There would be a decline in its relative competitive position on international markets, especially the American market, compared to the Canadian primary sector. My feeling is that the Bank of Canada would have to be involved in some capacity in the adjustment process. For instance, Canada may have to increase its official reserves if the Canadian dollar were to appreciate too fast, in real terms, from 1989 to 1998.

To conclude, let me say that it makes sense, economically and politically, that the federal and the provincial governments should help and compensate the workers and, to a certain extent, the firms, that are most directly affected by the change in Canadian trade and industrial policies. These things happen once in a century — 108 years after the adoption of the National Policy in 1879 — and the consequences of failure are so important that any prudent means must be taken to make sure that the objectives of the new trade and industrial strategy, oriented toward export-led growth, are realized. The 1911 fiasco and failure should be avoided in the coming months. And a failure to face the challenge of adjustment and the fears related to adjustment could play a big role if such a failure were to be

repeated. This will make sure that the "leap of faith" is truly a step forward and that the Canadian population is ready to take the calculated risk involved in this "continentalization" of the Canadian economy.

The uneasiness expressed in some parts of the Canadian population, beyond the purely ideological positions of certain people, is a reflection, in my view, that the adjustment process has not received enough attention from governments. This was probably unavoidable during the negotiations. I think, however, that now the adjustment process should receive priority and get into gear.

Discussion

Rosalie Abella

Jeffrey Schott:

I think Premier Devine made a very strong and clear-cut point this morning that adjustment is occurring all the time. I think one of the benefits of the free trade agreement will be to accelerate adjustment in both economies with regard to an expanding pie in both countries. So I share the views of both speakers that adjustment programs will need to be in place to ease the social costs of that adjustment, and also as a practical political matter to further the political acceptance of the deal. In the first place, it's the same experience that we have had in Washington, and adjustment programs were quite prominent when the Carter administration in 1979 sold the Tokyo Round package. I have one point, though, of question on the proposals that Professor Tremblay put forward. And that deals with the role of the Bank of Canada. There I cannot see how management of exchange-rate policy can be an integral part of an adjustment program. First of all, the Bank of Canada can't do it, it won't receive any help from any other member of the G7. Besides, what he seemed to be saying is focused on maintaining an undervalued exchange rate to provide a level of effective protection while we're breaking down trade barriers. I don't think that's desirable and I don't think it's feasible. So I wonder if you might comment on that element of your recommendations.

Rodrigue Tremblay:

First, let me say that I was putting myself in the framework of what if, what if, what if. If you asked me what I think will happen in the next century, when the next century comes about, I don't think the Canadian dollar is going to be that strong. I think we are in a cyclical down-trend of prices for raw materials, and currencies like the Canadian and the Australian dollar, have some way to go down yet. So, I'm not too worried about a big explosion of the Canadian real dollar. But you have to prepare if big inflation, world-wide inflation, were to push world prices very high and turn the terms of trade of Canada in its favour, like in the early part of 1970, after President Nixon floated the U.S. dollar. Regarding what the central bank could do during the adjustment process, they have to remember that we don't need a free-trade zone for the Canadian primary and resource sector. It's already a world-wide free-trade environment. The reason Canada wants to have a free-trade agreement with the Americans, is to enhance its manufacturing sector. To a certain extent, also the service sector, but we are risking much more in the service sector, and the Americans will tend to win more on the service sector side. So, it will be detrimental to Canadian interest if, for a cyclical reason, the adjustment were to take place with an appreciation of the real Canadian dollar. Because in that case, what is in the agreement, I don't think is sufficient to protect the manufacturing sector of Ontario and Quebec.

I think the reverse of what has happened since 1975 to today, where the manufacturing sector of Quebec and Ontario profited tremendously from the real depreciation of the dollar or could have if there were a 10 per cent real depreciation of the Canadian dollar. In the agreement, of course, there's a three-year possibility of suspending tariff reduction as a safeguard. It may be enough to protect a sector from being wiped out, but it may not be enough. If it were not enough, I think that the level of offshore reserves could fluctuate, because the level of off-shore reserves is a policy decision.

To take an extreme case, Taiwan has offshore reserves of nearly \$60 billion. Of course, the Taiwanese could have let the currency appreciate very much more, and I think they should. But I'm not talking about having \$60 billion of reserves for Canada. But between \$4 billion and \$10 billion there's some leeway. And it cannot last forever; it's a short-term measure.

But I think the central bank has a responsibility to smooth out the evolution of the real appreciation of the currency — as it does, as a matter of fact, when it tends to depreciate. So, the central bank goes against the wind, but I think it will have to go against the wind in a

more open-eyed manner during the adjustment period, if things were to turn against the manufacturing sector. It's a big if, but I think we would have to raise that point ahead of time if things were to develop in that direction.

I think the issues that have been raised in the first part of this morning's session are extremely important, and perhaps the point that has not been made strongly enough, though it was implicit in Jim McCambly's statement, is a very important political issue. It is not just important for the people who are directly affected, but for the whole framework and attitudes that are now necessary to make this agreement acceptable in this country.

I think it is reflected very well in that rather unfortunate episode in the House of Commons — two episodes where the Prime Minister talked about massive assistance and the Minister of Finance took a very different view. These, of course, reflected their personality differences, in part, but I think they also show the instinct of a politician against the instinct of a businessman or bureaucrat — and both of them are valid instincts. It is important that we acknowledge what those instincts were and what we should do and think about them.

Clearly, the record from the past, which some of us have been watching for a long while, is that the adjustment to situations of this kind is usually much less difficult than was anticipated. The European Community, for example, took a lot of pains to allow for adjustment assistance, and only very, very few industries actually had to experience the massive adjustment requiring government assistance. That record is very clear. In the case of the U.S. Trade Expansion Act of 1962, Kennedy and his advisers anticipated that it was very important that they have a commitment to adjustment assistance in order to get the support for that legislation from what was a rather protectionist Congress. They succeeded partly because there was great overkill in the adjustment assistance provisions of the act. It turned out that they also were unwisely administered from the political point of view because it was very hard to get adjustment assistance on the basis permitted by that Act. Politically, that has had a bad effect on the American attitude toward adjustment assistance subsequently, because now they tend to feel that it is not worth all the trouble; at least a lot of them seem to feel that.

In the case of the Canadian Auto Pact, a lot of people would think that 3,000 jobs is a small number considering the amount of assistance. That is, if you are sure those 3,000 jobs would be lost, then it is not a small number, but it is questionable whether the adjustment assistance was necessary. Coming to more recent events, you take the

work by Michael Trebilcock for the Macdonald Royal Commission. That analysis suggests to me the judgment that if there is adjustment assistance required, it is clearly for the workers. One should be very sceptical of substantial programs of adjustment assistance for industry. That can lead to a lot of wasted money, and the record is pretty clear on that.

I will come back to one point on that in connection with an issue Jeffrey Schott raised in a moment. Essentially, I believe we should be definitely in favour of Jim McCambly's point that the workers should be assured that the assistance is there for a period of maximum adjustment — even if it involves more of a program than we will actually need. That is the kind of political reason that was in the mind of the Prime Minister when he made that statement. I think that we do need that kind of adjustment element in the process, and it is separate from the trade agreement. I presume that because it is a temporary arrangement, it will be acceptable as national policy.

On the exchange rate question, I think one does have to anticipate the possibility of an appreciating Canadian dollar. That part must be included in our thinking. What do we do about that? I think it is very dangerous to try to shield manufacturing from that implication over anything but the shortest-run period, for the reasons that have been made clear in the exchange. What I would think would be worth looking at in that connection is some form of inducement that might even involve inducements to firms to adjust quickly. The reason I put that in is that I think we are sure that in the next few years there will not be a recovery in the resource sector that is sufficient to try the dollar out very far. We are not so sure about that, toward the end of this adjustment or transition period. Therefore, there is a special reason, perhaps, for thinking about certain specific short-term adjustments to cover a three- or four-year period. The other thing is, I wonder if the Government of Canada could contemplate some kind of inducement for federal governments, during the transition period, not to borrow outside the country.

James McCambly:

I want to make a couple of observations. First of all, I don't think the agreement precludes adjustment, the kind of adjustment we're talking about. We are not talking about grants to companies or giveaways, but we are talking about companies getting a great deal more equity and having the opportunity to gear up as they did in the Auto Pact. There were government loan guarantees in the Auto Pact that let them gear up to that market. They were all paid back. Along with

that, there was worker assurance that there was a safety net and they wouldn't be hurt, so it all worked very well. Jobs in the Oshawa area went from about 50,000 to 200,000. If you got three jobs for every person, you haven't got a problem with adjustment. That's what you have to target for. We are not trying to make a case that is going to be a big adjustment problem. But a thing that gets me concerned is like the recent Canadian Chamber of Commerce study asking how many people feel that advancing in technology is important to their business. And only 9 per cent said that it was very important. If you ask me to rely on Canadian business to create jobs and challenge that market with that kind of assessment, without government loan guarantees so they can gear up to that market, and without symmetrical adjustment and timing, we are looking at a tough game here.

One last point is that I don't think it is really even an issue that deserves any credibility in terms of any tough negotiation to remove tariffs. Why are tariffs there? Because they either are or they are perceived to be protection for workers or for shaky industries. And then they may become more than that after a while. Whether they are or not is another matter, but they are seen to be that. As Premier Devine said, governments of all kinds have eliminated tariffs. Let me give you one example. Sweden, considered to be the well spring of Europe with more multinationals based in the country per capita than any other place, has a labour movement that supports a situation where they will not perpetuate losers. But there is transition, there is agreement for a technological improvement, there is agreement for worker adjustment; that's what missing here. Without having that kind of assurance in Canada for such a major reduction in tariffs, which either are or are perceived to be protection, I think there will not be acceptance from the workers for such a move.

Labour Concerns About Free Trade

Jo Surich

I should remind you initially that our organization — the Ontario Federation of Labour — has opposed the negotiation of a bilateral free trade agreement from the beginning. That's not news, but that's reality. We have done so for a number of reasons that I will not burden you with here today. At the same time, I don't really wish to spend a lot of time talking about the specific terms of the agreement as I am not sure that would be particularly useful.

However, I do wish to spend a little time on the process by which we arrived at this point and on the process by which we appear to be moving into the future with respect to bilateral trade relations with the United States.

I must tell you also that our organization is not in favour of the agreement initialled on October 3rd. We have debated the general question in several conventions. We have debated extensively the question of what kind of direction we think the economy has to go in if it is to serve working people. Our organization launched a major effort throughout Ontario over the last two years, and I can say with some confidence that the work we did made a significant contribution to changing the balance of public opinion in Ontario on the free trade agenda.

Finally, I must tell you that I am a social democrat. I am not a free enterpriser, although I understand, appreciate and respect the kind of activity many of you are engaged in. I understand the ideology that provides the underpinning for that activity. On this question there are some fundamental and ideological and philosophical questions that need to be addressed. Those, in turn, will lead me to a discussion of adjustment processes.

First, it seems to me abundantly clear that the earliest proponents of bilateral free trade with the United States came to that position in large part because of an ideological predisposition. The basic proposition says simply that the market should be allowed to make all fundamental decisions. This is a perfectly respectable position, but it is one that people in the labour movement and people who lead ordinary working lives have to reject.

The reality is that the market, left entirely to its own devices, leaves people with relatively poor standards of work, with extremely bad standards of health and safety, without most of the social services we are now accustomed to. So, the fundamental assumption on the basis of which the federal government launched into this process is one that we have traditionally opposed and will continue to oppose. This is fair game in a society in which people have the right to hold opinions freely and state them publicly.

Perhaps even more importantly, the federal government launched into the process of negotiation without any consultation with the people of Canada. There was no debate in this country, even during the last election, about whether this was a good or bad idea. The federal position in pursuit of bilateral free trade was taken after a massive majority was gained in the House of Commons, indeed, after the potential for objection was largely undermined.

The reality is that nobody on the side of free trade wanted to spend any time whatsoever talking about the effects on the people who are most likely to pay the costs. Those people are working people. We all know that. I neither know nor care particularly whether Harris was right, or Cox was right, or Wonnacott was right, or the Economic Council was right. They all argue that there will be many more jobs. We could sit here and debate the economic assumptions and would probably end at a point where I would call them propagandists for the free enterprise ideology and they would call me a socialist nerd. There is little point to that exercise, and I will not engage in it.

The Ontario Ministry of Industry, Trade and Technology, study suggested originally that 273,000 manufacturing jobs in Ontario were at risk because of the nature of the industries those people worked in. I don't know if that study is right. People in favour of free trade have argued that the Ministry study was based on false assumptions. In a sense, this whole exercise must lead us to doubt the assumptions and data on all sides of this process. The latest Ontario government study suggests that there may now be 400,000 manufacturing jobs at risk. I don't know if that is entirely correct, but what I do know is that at the most minute level all over southern Ontario you find communities, plants and industries in which the people who work there — managers and workers alike — know precisely which jobs will be lost.

Those people know that their jobs will probably not exist in the relatively short term. They know that this agreement will hasten the process by which those jobs are going to disappear.

That is reality in the industrial world of this province. If nothing else has moved people to oppose this agreement, that has. They know where those jobs are because they see themselves as the primary victims.

This is not to say that industries in Ontario don't shut down as it is. We have only to look at the tire industry, for example, in which there used to be five facilities producing tires in Ontario. As of next January, there will be three, and this agreement will probably guarantee that, in the longer term, there will be none. Goodyear and Firestone have closed or are about to shut down. At Goodyear nearly 1,800 people have been thrown out of work. I spent weeks on the telephone with the victims, all of them trying to figure out what happens to them now. They had worked in the plant for 35 years, reached the age of 55, paid their mortgages, did everything solid citizens are supposed to do.

Out of the blue they were told that their jobs were gone because of a decision made internationally, in the United States, because of the speculative activities of a European investor.

This is the reality of displacement, dislocation and the need for adjustment. We deal with these questions daily just as Mr. McCambly has to deal with them daily. That's the real world of working people who do not even have the political mandate to proceed.

The problem is that, to the average economist, adjustment is an abstract notion. For working people, and those of us who work for them and with them, there are no abstractions. There is the stark reality of lost jobs, lost standing in the community, shattered families, savaged lives.

It is abundantly clear to most working people at this stage of the game that our government has no intention of addressing the adjustment process. Had it, for example, been the case that the federal government announced an adjustment process along with the notice of signing an agreement, we might have been able to avoid the fundamental divisions that now promise to tear this country apart.

Had the federal government announced a process by which we could fairly determine whether a job was lost due to the agreement, had there been an announcement concerning compensation for mobility costs, including the costs to communities, the costs of loss of equity in a home and so on, we might have avoided the divisions so clear to us today.

Had there been clear and specific recommendations about the way in which training and skills development would be developed in this country in response to the massive changes that must follow this

agreement, then, too, we might have been able to avoid the divisions. None of this was forthcoming.

Let me assure you that the divisions are powerful. They threaten the very fabric of this society. I would say for Mr. Culver's benefit that I am as much a patriot as he. I want to tell the Business Council on National Issues that those of us who represent the working people of Ontario have at least as much right to opinion, at least as much right to well articulated positions, and probably as much fundamental and philosophical basis for our opinions as an organization representing large numbers of multinational corporations.

The process of dividing this country is now under way. It is a process that will divide this country in a very fundamental way. Quite frankly, if that is to be avoided, adjustment is a key ingredient. If that division is to be avoided, then we have to have a clear agenda for who will pay what cost. We will have to have a clear agenda for who will be in charge of what part of the process of adjustment. We will have to have a clear agenda that says to working people: "You will not be the victims of a game being played by people who have power and influence in this country." That has not been done, and I see very little evidence that it will be done.

Let me talk a little bit more about the process through which adjustment could be established in this society and about the kinds of difficulties I think are inherent in the agreement as we seek to establish adjustment policies.

First, let us look at the part of the agreement that provides a seven year, or five-and-two-year, provision under which we are going to negotiate and determine what the rules for subsidy are. We are going to a process that will determine whether an adjustment program is a subsidy, whether public medicare is a subsidy, whether unemployment insurance payments to fishermen during the off-season are a subsidy.

At the end of that seven years, if we cannot reach agreement, we call the agreement off; we just say "no more". Let me refer you back to the point made by Professor Tremblay. Once seven years are up, once those parts of Canadian industry that are able to adjust and have the imagination to adjust have adjusted to the new economic environment, there will be no turning back for this country. It will not be possible to abrogate the agreement. It will not be possible for us to say that now we are going to change the rules once again and that we are going back to seeking to operate a more solid Canadian economy because, we will have been fully integrated into the American one.

In this process of negotiation the Americans represented their interests and understood them perfectly. Our negotiators sold out

the shop. When we get to the end of that seven-year period, the Americans are going to be negotiating with people who have far fewer bargaining chips than we had when we started this process more than two years ago.

I have no confidence whatsoever that if the people who negotiated this agreement are still representing us seven years from now, we will not end up agreeing that virtually everything is a subsidy, including an adjustment process for workers cast aside because of the decisions of politicians. This is also reality.

If it is, in fact, the case that it will be impossible for us to withdraw from the process, if people come to recognize that this is now the real world, then the position we took in the first place will have been fully vindicated. The point will finally have been made, as we have been making it since the beginning, that it is simply not possible in this country to develop a strategy for economic development of Canada which serves Canadian interests and the interests of Canadian working people in the context of a completely open bilateral free market arrangement with the United States. The reality is, and will be, that economic policy will be made in the United States, by the larger partner.

The majority of the costs will be paid here. The major trauma of adjustment will occur in Canada, not in the United States.

Finally, as Canadian industry begins the process of adjusting to this new reality, and it will — in many cases it has already started — demands for major reductions in working standards will rise. Industries seeking to adjust to the pressure of competition with counterparts operating in the southern United States where there are virtually no standards of health and safety, areas in which it is impossible to unionize, areas in which there are virtually no employment standards of the kind we have here, will put enormous pressures on our existing standards. What government in this country will resist those pressures? And, as they cave in to the demands for gutting standards and labour legislation, who will pay the price? The people who pay the price will be unionized workers here in Ontario and elsewhere.

The people who will pay the price will be the 100,000 who belong to Mr. McCambly's organization, the 800,000 who belong to ours and the large number of others who do not belong to any central body. The process that started in western Canada, a process designed deliberately to destroy trade unions, will find its way to Ontario because employers, even those who do not wish to participate, will have no choice because of the environment in which their competitors work.

In light of these realities, it can surely not be surprising to you that there are people opposed to this deal. Even if it were the most magnificently crafted piece, people would still have to be opposed to it.

The profound divisions that are an integral part of this debate will become more intense as time goes on, and we had better look at adjustment mechanisms that make sense. We had better recognize that an adjustment mechanism requires the intervention of the state in the economy to a much larger extent than your average flea market free enterpriser would want.

You cannot have free markets and adjustment unless you recognize that markets cannot be free. The state has to intervene.

I'm not sure there is much point in carrying on the debate about job losses. Let me start with your last point. What you are doing is flogging the position of the Prime Minister of Canada. It's a perfectly valid position, I just don't see any evidence in the agreement that that has been done. I don't think our relations are normalized at all.

For example, on the question of displaced workers it is easy in this kind of forum, playing with the numbers, to forget about the specific kinds of impacts that are explicitly contained in this agreement.

A very large number of clothing workers, immigrant women, who are not mobile, who face virtually no prospect of employment in the fancy clerical and other service jobs which this agreement is supposed to generate, will be displaced. These people don't face the prospect of employment, they face the elimination of large parts of an industry. I don't know how large a part of that industry, nor with respect, does anybody else, because we know very little about the way individual firms will respond to the agreement.

We don't know whether individual firms will choose to locate in South Carolina, because wages are lower, and standards of work significantly lower, and standards of health and safety virtually non-existent. We cannot confidently predict any of that. We don't know how many of them will choose to leave, we don't know how many of them will, in fact, be forced to close because they do not have the capital to adapt. Nobody can really predict that.

What we do know is that there are large numbers of people working in those industries whose livelihood or potential for livelihood, is severely threatened by this and we know, in turn, that our political leadership has given them absolutely no indication of hope for the kind of adjustment, training that is going to be required.

Canada-U.S. Free Trade: What the Economic Council's Simulations Say

R.A. Jenness

As with other members of this panel, the Economic Council has long endorsed the concept of trade liberalization, and it is on record as projecting that a free trade accord with the United States will bring increased growth and jobs to Canadians. Although at this juncture only the bare outline of the accord has been published, we are also on record as indicating that as the details become available, we will undertake new simulations to ascertain where the future benefits and the costs may lie. Generally speaking, to those of us at the working level within the Council, the announced framework of the accord seems to offer favourable prospects for Canada as well as the United States.

Since this session has to do with the economic, employment and regional impact of the free trade accord, let me review with you the results of earlier simulations that we issued about a month ago as part of our 24th Annual Review of the Canadian economy. The numbers themselves are obviously out of date; we could not anticipate all the details of the October 4th deal. But I think they are instructive, so here is what we did. Using new and up-to-date estimates of tariff and non-tariff barriers on both sides of the border, we simulated the medium-term impact of a comprehensive Canada-United States Free Trade Agreement on output and employment in the Canadian economy, which we divided into 36 sectors. Then we combined this data with Statistics Canada's provincial input-output model of the Canadian economy. This enabled us to get a province-by-province view of its effects.

All simulations, of course, are built on a set of assumptions. Here is what we assumed. We removed all tariff barriers immediately, as well as most non-tariff barriers, excluding those in agriculture. Discriminatory federal procurement policies were eliminated except for those involving military hardware. We assumed no changes in the Auto Pact. We did not deal with services, we made no changes to then-existing energy policies, and we did not deal with subsidies. On the basis of these relatively straightforward assumptions, our simulations told us that, by 1995, real output in Canada would be 1.6 per cent higher than it would be without free trade. That represents an increase in output equivalent to about half a year's growth, and it is roughly in line with the outcome of simulations that John Whalley recently undertook. The figure translates into an increase in employment over a non-free-trade situation of about 190,000 jobs.

However, that's not the whole story. As many speakers have indicated, duty-free and secure access to the large U.S. market will enable many Canadian manufacturing firms to take advantage of economies of scale through larger plant size, product specialization, longer production runs, faster adoption of new technology, or the exploitation of new market niches. This in turn will enable them to improve production efficiency and, as a result of the lower unit costs, increase sales and employment. The access to the wider market will encourage Canadian manufacturing firms to rationalize their operations, reduce the number of inefficient plants through mergers and takeovers, and modernize their production activities in order to compete successfully. This rationalization process will not, of course, be without difficulty. How much is likely to occur?

We undertook several estimates. First, we identified the number of small plants in each of the manufacturing industries with relatively high production costs, as compared with plants operating at most efficient scale levels. We found that about 70 per cent of all manufacturing plants producing about 20 per cent of all manufacturing output are operating at costs higher than, and at capacity below, what is considered most efficient for the industry. We found in every industry that if a process of rationalization somehow occurred, such that all plants were producing at optimal capacity, production costs would drop significantly. I must make one major qualification to this. Some plants may be operating at what appears on the surface to be sub-optimal scale levels but still be efficient and profitable. What is usually happening there is that these small firms are producing more customized or specialized products than the lowest-cost competitor firms in the industry. In such cases of product niche-finding, one would not always expect plants to expand under free trade.

We found, not surprisingly, that the potential productivity gains to be made from plant rationalization vary widely from industry to industry. They range from zero to 10 per cent. And overall, for manufacturing as a whole, these gains work out to about 6 per cent. Although the necessary process of rationalization and modernization would not occur overnight but rather over a period of time, we could nonetheless expect that through the increased competition a free trade accord will bring, most of the cost savings will translate into lower prices for consumers.

So we have two sources of price reductions. First, the surcharges that consumers pay because of tariff and non-tariff barriers disappear; second, industry-specific productivity gains translate into lower costs and prices. Hence we need a second simulation to cover this second productivity effect. So, carefully taking into account the fact that not all Canadian firms can or should expand to a uniformly efficient size, we developed an additional simulation that combined the removal of trade barriers with industry-specific productivity enhancements in specific Canadian manufacturing industries. And when we ran this second scenario we came up with an additional growth impact of 3.3 per cent, together with 350,000 new jobs, or the equivalent of more than one year's growth dividend. In 30 of our 36 economic sectors, output and employment increase. In terms of real income, the average Canadian comes out at least \$500 a year better off than in the absence of a free trade agreement.

Now let me be very clear about what is happening here. The stimulus imparted by trade liberalization will almost all be internally generated. Trade both ways will expand considerably — our simulations say by about 4 per cent, or close to \$15 billion worth by 1995. But we will almost surely increase imports by more than we increase exports. Traditionally our tariffs have been higher than the American tariffs and more widely applied. Their removal encourages imports relatively more than the equivalent removal of American barriers encourages imports from us. The growth and employment benefits that Canadians will derive from a free trade accord will be generated almost entirely from domestic spending increases. Canadians will spend and invest more because their real incomes or purchasing power have increased. Their purchasing power has increased thanks to lower prices when tariffs are removed and when Canadian firms rationalize their activities and produce at levels of efficiency appropriate to the North American, as distinct from the Canadian, market.

What do I mean by appropriate levels of efficiency? Let me give an example. Take breakfast cereals. In a market the size of the United

States, there is room for a great diversity of cereals only slightly differentiated by shape, sugar content and advertising. This advertising spills over into Canada and, with tariff protection, it becomes profitable for a producer to offer a similar array of products. Profitable but costly, since production runs are short. With the free trade accord, the XYZ milling company, instead of producing 10 different brands for the Canadian market, will specialize and produce one or two for the whole North American market, with longer production runs and lower unit costs. As for the other eight brands, we will either import them free of tariffs, or a new, efficient Canadian plant will be built to process one or more of them.

The gains from lower prices are nationwide and, for most Canadians and Canadian businesses, it is likely that the consequent increase in spending power will be saved, spent or invested in ways that are relatively predictable. Hence we would expect that the new jobs that will be created by a free trade accord would reflect traditional patterns of consumer spending and investment and be distributed among the various sectors of the economy much as they are now. And indeed our simulations support the view that the output and the employment benefits of the free trade accord will be distributed fairly evenly across all provinces, roughly in proportion to their current population, although the outlying provinces appear to gain slightly more than the two central provinces. Within provinces, the specific implications turn out to be determined largely by the composition of the industries that are located there.

Now this finding of the simulations, that as a result of the accord employment in all provinces should increase more or less proportionately, may seem counter-intuitive, since manufacturing — where most of the tariffs apply — is concentrated largely in Ontario and Quebec. And indeed we were surprised. But when we looked at the figures more closely it became clearer what was happening.

Over the last decade or more, roughly 95 per cent of the net new jobs created in Canada have been in the service sector. So it should come as no surprise that the effects of the free trade accord, working primarily through reduced prices and increased consumer real incomes and expenditures and business investment, should favour employment in the service sector. Indeed, we estimate that close to 70 per cent of the projected distribution of net new jobs in Canada resulting from the accord will be in service activities, 14 per cent in construction and only 12 per cent in manufacturing. As the distribution of service sector output and employment is more or less similar from one province to the next, all provinces benefit proportionately.

On a net basis, free trade results in job losses in only 6 of the 36 manufacturing and non-manufacturing sectors we simulated. These

are industries that currently receive a relatively large amount of trade protection and are already facing stiff competition from the low-wage developing economies. They include the electrical products, leather, textiles, knitting mills, rubber and plastics industries. However, the net job loss in these industries is small — 7,000 are the gross figures — those that take account of the displacements that may occur within an industry, where the layoffs of one firm are offset by the hirings of another firm in the same industry, or, alternatively, include those people who may not be laid off but are forced to move to a different occupation or location.

These figures are hard to come by even using all the data available from Statistics Canada. Needless to say, these movements are very difficult to predict. Nonetheless, based on individual work history data available through unemployment insurance records, we have made some preliminary calculations that should be interpreted as indicative and directional.

First, however, let me talk a bit about what normally happens in the economy in any typical year. Normally between four and five million people, or roughly one out of every three members of the labour force, lose or leave their jobs. Even more people enter existing or new jobs. About half of those who lose or leave their job do so voluntarily, moving on to new opportunities. Of the rest who lose their jobs involuntarily, about half experience temporary lay off, to be rehired later by the same employer. The balance, or over a million people a year, suffer permanent lay off. Some find new jobs easily; others have difficulty, particularly if they have to acquire new skills or move to another community.

Now let's go back to what I described as the gross flow implications of the free trade accord. Remember we talked in terms of 350,000 net new jobs being created over a period of eight years. Based on past industrial experience, we expect that this works out to about 180,000 jobs being lost and over 530,000 jobs being created in that timeframe.

The loss of 180,000 jobs may sound pretty ominous. But when you phase it out over eight years, it comes to about 23,000 permanent lay offs each year. This works out to only 2 per cent of the 1 million permanent lay offs that occur in a normal year. And, of course, because of the free trade accord, these lay offs are being offset by the new jobs the accord creates at a rate of 3 to 1. We conclude, therefore, that most Canadian workers would be able to adjust to the job shifts brought about by the Kennedy and Tokyo Round tariff reductions.

Within occupations, the job losses would be concentrated in product fabrication, processing, service, sales, clerical and managerial occupations. But ironically those are the very occupations in which the greatest number of new jobs will be generated. This heightens the

probability that most people losing jobs would find alternative opportunities in the same or closely related occupations.

Women would likely benefit more than men from trade liberalization, because the largest percentage of job gains would be concentrated in white-collar clerical and service occupations. However, a significant number of women, as well as men, now working in some of the older and less efficient plants in small towns in Ontario, Quebec and elsewhere, could well have difficulties in finding new jobs close at hand. It is this group of workers in particular that may need special government support or retraining attention. Whether the present set of federal and provincial labour market adjustment programs is up to the task, or whether new programs need to be introduced, is a matter for conjecture.

So much for our findings based on simulations of a free trade agreement undertaken before the actual terms of the accord were negotiated and announced. How relevant is what we have assumed and simulated with the realities of the signed document? We think we are still quite relevant. There will, of course, be differences. Our simulations removed all duties immediately and the time threshold ran only to 1995. The terms of the accord will be introduced more gradually. This means the gains will be more gradual, but so will be the adjustment.

As yet, the full and complete details of the accord, including which items will see duties removed immediately or in five or ten years, have yet to be spelled out. And there are other areas such as the definition of subsidies that still have to be worked out and may not be resolved for a number of years. So until most of the precise terms of the agreement are available, I can only speculate on the results. But my speculation leads me to believe that when our new figures do come out, they will point in the same direction as those that we have indicated.

Why do I believe this? Well, remember what we simulated. We postulated that all tariffs on both sides of the border would go. We postulated that most non-tariff barriers would be eliminated, and both federal governments would mutually open up their procurement markets. Our trade simulations did not deal with services or energy, and we assumed the Auto Pact would remain as it is. Remember, too, that by far the most important stimulus to job creation in Canada came through lower prices generated first by the removal of tariffs and non-tariff barriers and second by the improvements in manufacturing productivity, plant rationalization and greater economies of scale, and trade into the enlarged American market.

Under the new accord we can still expect the job creation stimuli to come from removing tariffs and lowering prices. We lose some of the impetus associated with open access government procurement because, under the agreement, that is only partial. We also lose the impetus from the removal of non-tariff barriers since virtually all of those remain. But we get pluses from features of the trade deal that we did not factor in. The inclusion of services that are to receive national treatment will undoubtedly give rise to new types of services, which themselves are labour intensive, and open up many opportunities for expanded trade between the two countries. By doing away with virtually the last vestiges of the old Federal Investment Review Agency, the deal makes Canada more attractive to U.S. investors. Including energy will encourage renewed investment in that sector and increased sales of Quebec hydro electricity and of natural gas and ultimately of off shore oil to the United States. The Auto Pact is preserved intact, generally requiring more, not less, North American content.

In essence, while the content of the signed agreement may be different, the thrust and direction of much of our original message remain the same. Within the new agreement, the core of the growth stimulus to Canadian output and employment remains; higher real incomes brought about by lower prices, made possible by the mutual removal of all tariffs and increased specialization and economies from a greatly enlarged market. The negative associated with the failure to remove non-tariff barriers or to achieve 100 per cent open borders for government procurement is likely to be balanced, at least in part, by the positive offered to both countries by including services, energy and a more hospitable investment climate.

Undoubtedly, the results of the signed trade agreement, when all the interactions work themselves out, will look different from the simulations contained in our 24th Annual Review. But there is every reason to believe that the material benefits that will flow to Canadians from the signing of this historic document will be substantial.

Economic Regional and Labour Market Adjustment Implications of Canada-U.S. Free Trade

John Whalley

When I was invited to speak at this conference, I was asked to cover the economic, regional, and employment effects of the recent trade agreement. Because of time constraints, I may not be able to cover all of these, but I will try to make some comments on all areas, focusing more heavily on the adjustment issues that the agreement raises.

Let me begin with the agreement. I see it as a joint tariff elimination agreement, a new dispute settlement procedure covering subsidies and anti-dumping, and a long list of new bilateral codes, the key ones covering investment, procurement, safeguards, energy, agriculture, and autos. It is obviously a broad-ranging agreement, and, at the time of writing, we do not have all the details. That makes any assessment much more difficult.

In terms of long-run effect, it seems to me that there are three issues. First is what improvement we've got in our access to U.S. markets since a large fraction of our exports (around 80-85 per cent) already enters the U.S. duty-free. And the opportunities to improve access further are somewhat limited, reflecting the remaining high tariffs in the U.S. such as in textiles, apparel and petrochemicals. There is no doubt that we have some improvement in access since the remaining U.S. tariffs will be reduced. But it is clear that as the details begin to filter out, the improvements we have made in our access may be hemmed in and restricted in a variety of ways. In the textile and apparel area, for instance, where the U.S. tariffs are highest, the content provisions that specify the fraction of Canadian- or U.S.-made cloth in apparel exports will partially undermine the improvements in access that we may have thought we had secured. It also seems as though there are other areas that fit the same mould.

In terms of improvements in security of access, until we know how the bi-national panel is going to work, we will not know too much. The hope is that there is some improvement here. There has already been some speculation as to which of the trade-restricting cases we have been through over the last four or five years may have been different if we had had the panel procedure in place. A number of people that I have spoken to feel that we would have had a different outcome on softwood lumber. If that is the case, it would be significant; but there may be only that one case.

I would also say that, to my taste, the importance of the security of access issue may have been overblown from a Canadian perspective. I would draw your attention to a recent paper in the *World Bank Economic Review*, by Chong-Hyun Nam, on countervailing duty actions in the U.S. If you look at the fraction of Canadian trade flows into U.S. markets currently covered by countervailing duties, the number he has is 0.9 per cent. If one is dealing with countries like Korea and Brazil, it's up in the 15 to 17 per cent range. His numbers are only up to the end of 1985; they do not include softwood lumber and potash. And although the numbers are relatively small, one also has to evaluate these things in terms of the wider threat the measures pose.

Now, what about the other areas of the agreement? What have we given up? I think it is here that the academic economists would be almost unanimous in stressing that it is wrong to think of this agreement as being in any way a zero sum game. What we have given up produces outcomes that in the long run are in fact in the national interest. In the long run, we make ourselves better off by giving up the Canadian tariff and by giving up other protective devices and binding the use of distorting domestic policies. There is an element of self-binding in the agreement that many economists would see as nationally advantageous in the long run.

Now what about the size of some of these effects? If you look at the studies of Canada-U.S. free trade, going back over 30 years to the original calculations done by John Young in the 1950s, and through all the subsequent ones that Ron Wonnacott and others have done, through to the Harris/Cox work, the range you come up with is around 4 to 10 per cent of GNP as the gain to Canada. That is the range that was in the Macdonald Commission Report which surveyed much of this literature.

I think it is also agreed that these numbers are too high when applied to the current agreement. First of all, tariffs are now much reduced compared to the levels that applied when these studies were done. Even if you take the Harris/Cox work, the studies were done with pre-Tokyo Round tariff data. And we are now dealing with

significantly reduced tariffs. Also, if the improvements in access that we are seeking are restricted in various ways, the effect is to reduce further the size of the gains. My understanding is that some recent recalculations of the effects, using the Harris/Cox approach with more up-to-date data and estimates of barriers, produced significantly smaller numbers.

From these academic studies, it would seem to me that the consensus is that there is a positive long-run gain, but it is probably lower than some of the larger numbers one hears quoted based on studies using earlier data. In the Harris/Cox work, maybe 4 per cent of the 10 per cent total gain comes from the elimination of Canadian trade restrictions. Given what I was just saying about the access side of this agreement, we may actually get more gain in the long run from eliminating our own barriers than from having U.S. barriers eliminated. I state this only as conjecture, but there is a case here I think one could argue persuasively.

These studies provide no handle on the security dimensions of improved access. The insurance value of improved security over U.S. trade measures is not reflected in any of these studies. So, presumably, the benefit to Canada has to be increased a little to account for this.

Let me move now to the regional effects. The traditional view on the regional effects of a Canada-U.S. trade arrangement breaks down as follows. What happens when you remove the Canadian tariff? And what happens when you remove the U.S. tariff? The traditional view has been that the Canadian tariff benefits Ontario and Quebec, because they can export to other provinces in Canada behind a protective barrier. As a result, the rest of Canada loses. Some years ago, Hugh Pinchin estimated that the gain to Ontario and Quebec from protection was about 1 per cent of income. There is also a study of British Columbia, done in the 1960s by Munro, Young and Shearer, that estimates the loss to British Columbia at around 4 per cent of income. So these inter-regional effects are certainly potentially significant.

But the traditional view of the U.S. tariff is that it hurts Ontario and Quebec, which tend to lose from the presence of barriers in the U.S. since they are concentrated on manufacturers. If we get those barriers down, the regions that export manufactures are going to benefit. So if we have joint elimination of both the Canadian and U.S. tariffs, there are offsetting effects in terms of the interregional gains and losses. How both of these work out together is unclear.

Into all this one also has to inject what I call the new view. The Harris/Cox calculations suggest that the rationalization effects that would accompany Canada-U.S. free trade are so large that all provin-

ces would probably gain. Thus, it is not an issue of one province gaining at the expense of others as a result of interprovincial trade behind a national trade barrier. In turn, the manufacturing sector expands in Harris/Cox as a result of free trade. There are several issues of data and assumptions with the Harris/Cox calculations, but in the view of the world implied by their model it would seem that all regions would gain from the trade agreement.

In addition to the interregional effect of the tariff, one also has to look at the other policy elements in Canada and how these may be changed by the elimination of tariffs. A very important matter is the interprovincial trade barrier issue. There are some people that have argued that interprovincial trade barriers may be nationally desirable given the presence of tariffs, because they tend to offset some of the deleterious effects of the Canadian tariff. The tariff will tend to promote interregional trade; if you slow this down with an interregional trade barrier, you can actually end up in a position where you are better off. I would not go so far as to advocate that all interregional barriers fit that pattern, or that all are desirable. But it suggests that the interregional effects of the trade agreement are something we have to address.

We know that interregional trade is about the same size as Canada's international trade. Also, the western provinces tend to be net importers inter-regionally and net exporters internationally; it's the opposite way around in central Canada. An agreement that promotes international trade at the expense of interregional trade has a negative effect on the provinces that have been dependent on interregional trade, such as Ontario.

Finally, to close the discussion of regional impact, there are some interesting issues beyond the tariff. In the energy area, as I have already mentioned, I think there will be a clear gain for the West. The gain is basically the security value of not having to encounter a regime comparable to the National Energy Program used in the early 1980s, and the use of price controls by the federal government with the political support of central Canada. My impression is that this is one of the reasons for western support of the agreement; in effect protection for western Canada from central Canada provided by an international agreement.

In the agricultural area, it seems to me that the elimination of the meat import quota on both sides is also going to be advantageous to the West, although there are some changes in the western grain transportation arrangements that are negative.

Let me now move to effects on employment. There are several estimates of job gain or loss circulating at present, and it is often

difficult to know what to make of these numbers. There is the Economic Council of Canada estimate of 350,000 jobs gained by 1995 that Bob Jenness has talked about at this conference. At one point there was a figure of 500,000 jobs lost that I think the Minister of Employment and Immigration had mentioned, although that was just a scenario being considered. I will divide my comments into long- and short-run job impact issues, and I will raise some questions about the Economic Council study.

In the long run, it seems to me that it's very difficult to come up with a firm number or even a firm conjecture as to what the effect is, in part because modern macroeconomic theory is itself in disarray. There is one group of macro economists that fundamentally believe in market clearing. They believe that shocks will hit economies, but the labour market will eventually clear. These economists would say that the long-run effect of this agreement on employment has to be zero, and it is as simple as that. There are going to be some short-run effects, but markets will clear fairly rapidly.

There is another group of economists, which I would label as structuralists (or you could regard them as Keynesians), that would argue that there is some downward rigidity in real wages in the labour market, and therefore you have to look at the different sources of stimulus or withdrawal from that market.

The argument is that an increase in exports increases employment; an increase in imports reduces employment because of the substitution of imports for the output of import-competing industries. The issue is, what is the net effect?

Having seen the Council working paper by Sunder Magun and his associates, I would say the Economic Council work fits in this kind of category. They have done detailed and careful data analysis and, to their credit, this is the only piece of such work we really have on job gain or loss estimates as a result of the agreement. The problem is that they have used an off-the-shelf macro model, *Candide*, which is not really designed to analyze the trade job issue. From my reading of their discussion paper, there are certain features of the model that largely lead to the result that they get. My impression is along the following lines, and Bob Jenness may be able to correct me if I am wrong — the model has around 90 equations, and it is easy for me to misread it, and so I qualify it in this way.

In the model there is an external sector balance condition that says the value of exports must equal the value of imports plus the capital flow. What happens in most of the cases the Council examined is that the import response is small, the export response is large, and there is a large net capital inflow. In some of the simulations, the capital

inflow into Canada yields something like an annual 7 per cent increase in investment by 1995. If you cumulate this through the period they are looking at, the net effect would seem to me to be that this large capital inflow in the model is itself a major source of job creation. Why one has to be careful is that, from my reading of the model, the external sector balance condition has a capital flow treatment that I call "passive". It is not driven by changes in relative rates of return on assets, changes in investment climate, and so on. My conjecture is that I could use this same model structure and develop a scenario in which, if I got even less access abroad, there would be smaller growth of exports, larger inward capital flows and larger growth of employment.

It is all too easy for modellers to point these sorts of things out about each other's work. And all numerical models, including many I have worked on, are riddled with these sorts of problems. It may even be that my comments are wrong. But it does seem to me that one could probably write down a model structure alternative to that used in the Council work, with alternative behavioural responses for capital flows, and could probably get substantially different numbers. For that reason, I would be a little bit cautious about the estimates of 350,000 jobs gained. This Council estimate, in fact, breaks down into two parts: 189,000 job gain from the sort of analysis I have just mentioned, and the rest from an extraneous calculation of rationalization effects. Now, in a Keynesian model, if you introduce extraneous efficiency increases, increases in income effectively occur, and there will be an increase in employment. I would, therefore, approach the results of this study with some caution for this reason also. But, as I say, it is the only one that exists and it has a lot of detailed, careful analysis underlying it.

Let me now move on to the short-run effects. This is where I feel we should be focusing — explicitly on the adjustment costs. To my knowledge there has been no careful study, indeed, no study, of the adjustment costs of Canada-U.S. free trade, either in the academic community or, to my knowledge, within government. This is, in part, because of the data and modelling requirements of such an effort. And, as I will mention in a minute, calculations for other countries are equally incomplete.

The Harris/Cox study does not provide any estimate of adjustment costs, but it does suggest large long-run changes in the economy because it projects such large increases in income from an agreement. The original Harris/Cox study suggested around 7 per cent of the labour force in Canada would need to change jobs, and as many as 50 per cent of firms in Canada would eventually disappear

through rationalization effects. These estimates are, in part, a reflection of the large barrier estimates that were used in the study and of the treatment of market structure and scale economies. But to go beyond that work and actually calculate adjustment costs, you need to have estimates of duration of unemployment, propensities for workers to move between industries and regions, and data on the age structure of the work force by industry.

There have been a few studies of adjustment costs made for the U.S. and other countries. It seems to me, in the absence of studies for Canada, that is the best we have. These studies look at long-run gains from multilateral trade liberalization and the short-term adjustment costs and compare them one against another. These studies seem to suggest that the long-run gains from trade liberalization dramatically outweigh the short-run costs, perhaps by something like 10 to 1, some of them as high as 80 to 1. The numbers in Canada would probably be different because the geographical structure and barriers are different. There is also, however, an important figure which Ron Wonnacott has mentioned to me, that is in the study he has just done for the C.D. Howe Institute on adjustments costs and trade policy. Ron's figure is that 4 per cent of the Canadian labour force changes jobs every month. If that is the case, it may well be that many of the adjustments one is talking about under free trade could be absorbed relatively quickly, although if affected sections are in remoter regions and have an average older work force, the adjustments will take correspondingly longer.

Finally, some comments on adjustment programs. The discussion thus far in the conference has focused less on quantifying adjustment costs and more on arguing the pros and cons of an adjustment assistance program. If we get into adjustment assistance, we will have to design our programs carefully. The American experience with the Trade Adjustment Assistance Act in the 1970s, which came in as a result of the Kennedy Round, suggests that there can be major problems.

First of all, the eligibility criteria were very tight because of the difficulties in identifying trade-induced unemployment from other unemployment. It could often take periods as long as a year or more for people to become eligible for adjustment assistance. The budget outlays under this program were, in fact, so small because of tight eligibility criteria that, by the Tokyo Round, U.S. unions no longer supported an adjustment-type approach. In turn, the way the program tended to operate was that if you qualified, you were given a certain sum of money for a certain number of weeks, around 60 weeks. After that you were terminated from the program. Most

workers that came into the program remained fully unemployed for the 60-week period, to take full benefit, and then subsequently found employment. So there was discussion at the time about how you redesign such programs. Should they be lump sum, should there be a declining support level, so that the longer you remain unemployed, the less support you get. That itself would seem perverse from a purely redistributive point of view.

In summary, my overview of effects is somewhat out of kilter with some of the present debate. My conjecture is that the long-run economic benefits are positive, but smaller than the sorts of numbers associated with earlier studies. Also, a disproportionately large part of the gain will come from removing our own barriers rather than from improved or more secure access in the U.S. Also, most of what some people portray as Canada "giving up" is, in fact, changes that many or most economists would say are in our long-term national interest.

On the regional front, I believe these effects are very important: interprovincial net exporters in Ontario will lose markets in western Canada, and western Canada will gain and Ontario lose. The energy component of the agreement importantly protects western Canada from a return to federal government pricing policies, such as the National Energy Program, that benefits central Canada.

On the job front, there are large uncertainties about the job gain or loss, and these are questions I raise here over the studies of job gain. (If I had the studies I am sure I would be equally sceptical over the estimates of the job loss.)

Surprisingly, there is, to my knowledge, no meaningful calculation of short-term adjustment costs following from the agreement either in government or in the academic community. Studies for other countries seem to suggest these might be small, but even these studies are few, and their applicability to Canada is questionable. Finally, I suggest that if we introduce any adjustment assistance, we would be well-advised to look at the experience with such programs elsewhere.

Discussion

Rosalie Abella

Now I know what equilibrium means. It was fascinating. I think we've had an extraordinary display of analytical prowess this morning, dealing with some of the more complicated issues of this deal and it's open to the floor now to ask questions arising from these five presentations.

Ron Wonnacott:

I believe I detected my name mentioned in Mr. Surich's comments. I believe it's important if you are going to represent the position that other people take, that you do so accurately. It is quite true that I was one of the early authors, along with Ted English, who wrote on this subject. Your charge that we take the ideological view — to quote you, "the market should make all decisions" — is simply not correct.

Let me give you points on which we are now on record as favouring government intervention — not only safety in the workplace, which you mentioned, but control of pollution, resource conservation, a fiscal redistribution of income, and a much longer list, where we specifically concede that the government has a very important role to play in intervening in the marketplace. And in fact, as John Whalley indicates, along with an associate at the University of Windsor, Rod Hill, we have just published a book, which was released about 10 days ago, on the particular issue of adjustment assistance. We concluded that the first priority of the government should not be to assist firms, but to assist the labour force. In fact, as I listened to Mr. McCambly this morning, many of his recommendations are recommendations which we have also made. We do have a problem on the question of

loan guarantees. It seems to me that when you are assisting firms in this way, you have a potential problem in Canada with countervail. A major issue should be how to work in those kinds of programs within the context of an agreement in which they would not be countervailable. If it is the question, for example, of making loan guarantees, how can these be made in a way in which we can avoid that kind of U.S. response?

My major point would be one of disappointment. It seems to me that, in your emotional appeal, you've set your face against change — on the grounds, it seems to me, that there would be job-switching. We don't have evidence to support the claim of overall job loss. Even the study that cites 271,000 jobs at risk also cites a large number of jobs in which the prospects for expansion are very, very good. So that study is very consistent with the other studies that have been made. That indicates that, under this kind of agreement, the net effect, in any direction, is likely to be in terms of increased jobs. It seems to me that the charges are without regard for the job-switching that already takes place. We've heard about this from other speakers this morning. They are also without regard to the job losses that we are going to face if we don't normalize our trade with the United States.

Jo Surich:

I'm not sure there is much point in carrying on the debate about job losses. Let me start with your last point. What you are doing is flogging the position of the Prime Minister of Canada. It's a perfectly valid position, I just don't see any evidence in the agreement that that has been done. I don't think our relations are normalized at all.

For example, on the question of displaced workers it is easy in this kind of forum, playing with the numbers, to forget about the specific kinds of impacts that are explicitly contained in this agreement.

A very large number of clothing workers, immigrant women, who are not mobile, who face virtually no prospect of employment in the fancy clerical and other service jobs which this agreement is supposed to generate, will be displaced. These people don't face the prospect of employment, they face the elimination of large parts of an industry. I don't know how large a part of that industry, nor with respect, does anybody else, because we know very little about the way individual firms will respond to the agreement.

We don't know whether individual firms will choose to locate in South Carolina, because wages are lower, and standards of work significantly lower, and standards of health and safety virtually non-

existent. We cannot confidently predict any of that. We don't know how many of them will choose to leave, we don't know how many of them will, in fact, be forced to close because they do not have the capital to adapt. Nobody can really predict that.

What we do know is that there are large numbers of people working in those industries whose livelihood or potential for livelihood, is severely threatened by this and we know, in turn, that our political leadership has given them absolutely no indication of hope for the kind of adjustment training that is going to be required.

Rosalie Abella:

Any other questions. Did you have your hand up there?

Klaus Stegemen:

It may not be fair, Madam Chairman, to ask my question to the speakers, because they've all pointed out to us that there's a big hole in the federal government's program in that there is no provision for adjustment assistance. And even if we believe that adjustment assistance may not be necessary because workers can find jobs without adjustment assistance, we've also learned that for the government to get political support for this deal, an adjustment program must at least be seen to be in place.

My question, which I ask, not to the speakers, but to someone who could speak for the federal government, is: Why is there no provision for adjustment assistance?

Rosalie Abella:

Anybody want to take that on? Anybody not with the federal government who wants to take that on?

Ron Wonnacott:

There are two ways of doing this, and the way the government is doing it is to argue that there are very substantial programs that now exist. And there are certain advantages in having these programs ready to be topped up quickly and new programs introduced as the

need arises. The alternative is to announce a new set of programs at this time. There are advantages and disadvantages to those two approaches. Announcing new programs at this time is politically more attractive. Because the concerns of people who've spoken on this issue are better met at this early date. The other alternative is less popular politically, even though it is possible to make a more attractive program. I don't like to pass judgment on the two. I went on record 10 days ago, favouring the approach of bringing these programs forward, but I can see both sides of this case. There are advantages to the government's approach in the sense that it may well reduce the amount of money that is spent in ways that do not deal effectively with the problem, and therefore conserve funds for a more specific attack on specific problems as they develop.

Jo Surich:

Just a very quick point. I understand the nature of that dilemma. The only comment I would make is that the existing programs are not particularly good — and I don't suppose there's anybody here that disagrees. What puzzles me is that, for example, over the last two years there have been major changes in the treatment of severance pay, so that those 55-year-old men who got kicked out of Goodyear in Etobicoke will not collect unemployment insurance until they have exhausted their severance pay. Now if you look at the actual data from people who collect severance pay, you find that the majority in particular age groups take that money and start small businesses. I would have thought a government ideologically committed to that proposition would not in fact move to restrict the capacity of older workers moving into the market that allows them to make a living for themselves. And, yet, that's what has been done. That's the nature of the policy that we deal with. I think the explanation is simple; they think it immoral to take the money, but not immoral for GM to take \$200 million to upgrade a plant.

Daniel Roseman:

A couple of years ago when the government decided to phase out protection for the footwear industry, it did not introduce any special adjustment programs. At that time it said that the programs that are generally available are quite satisfactory for dealing with all those problems. And the adjustment did take place. I don't think that

anyone at this point has identified any major groups of people who remain unemployed as a result of that.

Now the Prime Minister, with his announcement on October 5th, just after the agreement was made available, said that there would be a massive program of assistance. I take that to indicate that this is a political judgment in order to sell it, in the sense that adjustment assistance is politically necessary in order to make trade liberalization palatable. But coming back to Ron Wonnocott's comments, I would wonder whether the government would want to get into any specific programs dealing with specific problems, because that's where you get into countervailable subsidies. If your adjustment assistance is generally available, then it shouldn't be countervailable under GATT rules, and presumably those rules would continue to apply under the bilateral arrangement.

Dick Lipsey:

I think Ron Wonnacott presents a very balanced answer to the question about assistance programs. I would like to add, coming from a position not notable as being on the left, that a very good reason for not taking that balanced approach is that nobody trusts the government. And if you are not trusted, you can't say, "Just wait until the problem develops and then if we get a serious enough problem we'll do something." You need trust for that, and the government doesn't have it, and that's why I think if they want to show that they mean business, they have to say either, "we don't need an adjustment program", and say it now, or say, "here's what the adjustment program will be". Some governments could have waited to see if adjustment problems do develop, but this one can't.

I do want to say just one other thing, having stuck my neck out. There's a popular misconception on this, so I want to defend our number gatherers, just slightly. When I quote a number and you quote a number, and somebody else quotes a number, and we throw it around — that's proving anything with statistics. We all know that the world is complicated enough, that you can find one number that seems to support your position, whatever it is. We must, in all conscience, distinguish that from the dedicated research of people who spend years of their lives trying to find out what really happens. For they have published their numbers, published their assumptions, and left them open to criticism. I've written a criticism, to some extent, of some of the work that's been done here. That's work that is useful because it is open to criticism and it's open to advancement. I

do hope, as the debate goes on, that we will distinguish, in our criticism of the number jugglers, between those who quote a number here and quote a number there, and those who follow reasonable standards in their research, and leave it open for those of us who disagree to say where we disagree.

Rosalie Abella:

That's why judges don't use numbers. They use Latin phrases, because nobody understands them and they can't criticize them.

Ed Safarian:

I'm going to try to throw a little bit of doubt on what I think is a consensus developing here, which may have a problem in it. I can think of changes that have happened in Canada as a result of government policy in the last 20 years, that had employment effects at least as large as the ones that we've heard of, where no special programs were developed for the workers involved. The decision to keep the price of oil low, relative to world levels, and the other decisions that went with that, had enormous implications through the '70s; it drove the macroeconomy in this country. There was no provision for labour adjustments of particular kinds that were affected. The decisions that were made in the early 1970s, when we had an enormous increase in social security and regional development, unemployment insurance and so on, had enormous effects. It required raising taxes that affected employers and workers in other parts of the country. No provision was made specifically for the particular effects that putting another \$100 million into Nova Scotia had on workers in Toronto or Vancouver where a lot of the taxes fell.

Now, I haven't costed those programs out to know how large they are, but intuitively I think the costs in terms of adjustment were very substantial. Surely, no one here is saying — least of all the people from organized labour — that we should not encourage change, because a lot of the changes we want to encourage are ones that are very important to all of us, changes in terms of technical innovation and so on. Are we going to try to develop a set of policies for every major change that I hope we undertake in the future? For labour adjustment in that particular case? That seems to me to be a misleading way of looking at it. Surely what we should be doing is saying, if there are gaps in the policies we now have — and we have a lot of

policies to assist labour adjustment — if there are serious gaps there, and realizing that we are going to be facing not just a trade adjustment but all sorts of other big adjustments in the years to come, why don't we concentrate on trying to close those gaps? I wonder if that isn't an approach that deserves more consideration than I've heard for it today.

Rodrigue Tremblay:

I think it's a question of degree and a question of realism. The question of degree relates to specific programs — specific policy changes like a textile policy and things like that — the upheaval was not overall, as it will be with that change in policy. This is a change from 108 years of national strategy, from import substitution to export promotion. It crosses all over the economy. It's a basic change of trade and industrial strategy, and therefore the degree of change is much higher and the structural adjustments are going to be much more widespread. That's the first point.

The second point is a question of realism. On the specific changes that we refer to, there was no referendum on these questions and there were no general elections held on these questions. What I'm afraid of is that the 1911 fiasco will repeat itself. There will be a proposal, which I think is good for the Canadian economy and good for Canadians, put forward by a government which has 24 per cent in the polls. It is opposed by two parties that have said that they are going to tear the agreement apart if it is signed before an election. Or if it is not signed, they will not sign it if they're in power. Therefore, if you are going to have an election on one issue that is so paramount, you had better make sure that things are clear, as Dick Lipsey said. You better make sure, because the losses are going to be tremendous if the Canadian population, because of misunderstanding and lack of confidence, throws the deal out. As we are talking now, I would not bet that that deal is going to go through. I think that people don't trust politicians, and sometimes rightfully so. And I think that the Canadian public is entitled to have clear programs and clear messages. I, for one, much prefer that there be a referendum on the question, rather than an election. There is 49 per cent now in favour, but that could go down, if the demagoguery continues and there is a perceived lack of programs, lack of things to protect the losers who are missing. Therefore, I don't think this is a minor thing. It's very crucial because the entire agreement and associated benefits for Canada, are in jeopardy.

John Whalley:

This is just a reaction to Ed Safarian's question. All the studies that I have seen for OECD countries very clearly show that if you look at employment changes and you try to decompose sources of them, changes in trade policy are a very small component of the underlying sources of changes in employment. In turn changes in trade are also small compared to much wider influences of macro economic policy, technical change, and so on.

Now every country that I know of that's flirted with adjustment programs has got into the discussion, first of all, of why you would want to just compensate people who have adjustment programs due to trade policy changes. Why not do it for technical change, and for changes in interest rates. And then you're in a huge, huge, adjustment program. Then there's been a discussion — and there's also an issue — of why we should transfer funds to somebody who is, say, making \$30,000 a year, and has to go through an adjustment process, compared to transferring funds to a single mother with two children and \$10,000. The complication of those two factors in the policy debate seems to have led to the conclusion that the only rationale for these kinds of programs is a political rationale. The rationale is: That's what makes trade adjustment politically acceptable, and I think that's one of the messages in the Trebilcock volume that Ted English mentioned.

Jim McCambly:

I'll try to be brief. It's the kind of subject you could talk about all day, and it's very interesting and complex and needs to be talked about. I don't think that we have a good system in Canada that enables us to move in a way that we can take advantage of technological change and encourage it. Most of the time we have obstacles in the way of the kind of change and the speed of change that people are talking about. Most people also don't like someone coming to them and saying: "I'm from the government, I'm here to help you." So if you lay down programs specifically in advance, or take the options Mr. Wonnacott suggested — I suggest one more — in the interim at least, there ought to be a private sector advisory committee that is on top of these issues daily so that, as much as possible, the criteria for the adjustment are in tune with what's good for labour and business in the community. It would have to make sure that available funds are not wasted, because there can be big waste in adjustment if it is not geared

properly. But, from the government perspective, there needs to be a security blanket commitment to say, "We're prepared to look after people." We're talking about removing tariffs that were put in place by government; the people have been working behind those tariffs, and if government is going to remove them, then it has an obligation to take care of any kind of adjustment that may occur because of that. So if it is a government decision, right or wrong, it had better be able to put up and say: "Look, this is good for the country, workers are not going to suffer, we're going to make sure they don't, and we're going to put together a package that will make sure that happens."

Two tiny things. One was mentioned on loan guarantees. Very important. The only possible countervail argument that can be put up for government loan guarantees to expand business is that you might get a lower rate if you go to the bank for the government loan guarantee. That's the only possible subsidy. We're not talking about lower subsidized rates of interest or grants or that sort of thing — we're talking about guarantees that will offer expansion.

VI
Sovereignty Issues

The Effect of the Proposed Free Trade Agreement on Sovereignty Issues

Gerry Caplan

The first question is whether the free trade agreement, in fact, binds us irreversibly for the future. Second, if it does, does it matter very much?

I understand very well that there are a million constraints on governments without an agreement like this. There are constraints of history — they are the institutional bonds that can't be broken easily. I remember Mr. Trudeau saying — and I think it's the only thing that I ever agreed with him about — that only 10 per cent of the world was free for him to mould. Helmut Schmidt of West Germany used to say the same thing. They were shocked when they came into office to find how little control actually was left to them, how little room there was to manoeuvre. And the question is whether free trade tightens those restrictions in a way that is harmful.

I think I don't want to spend very much time on the first question: Are there going to be irreversible constraints? It seems to me that there is some agreement between the pro and anti sides that, in fact, there are going to be irreversible consequences, and I think it is fair to say that a number of people who support the agreement are pleased about those consequences. I think it is also fair to say that if we move even more organically into part of the North American economic system, it will be more difficult than it has been in the past for a Canadian government to have the flexibility to move in ways that are not congruent with that dominant economic system; and that are not consistent with what our American partners will find acceptable from a Canadian government. I don't mean that provocatively — I think it is irresistible in the logic of the situation. If we choose to become a tighter part of a market-driven economy, to use the phrase that the Macdonald Commission uses for it, the consequence will be

to sacrifice the capacity to be more of an interventionist economy, to have more of an interventionist government. Again, I believe that is not provocative, because I know people on both sides that agree with that. I think part of the motivation of some who support the agreement comes from their belief that it will make interventionism more difficult than in the past. They consider that a positive value. We can fight about it later if it seems more controversial that in fact there are going to be irreversible consequences of that kind.

I guess I am obligated to say a word about the cultural field. Abe Rotstein asked me if I would. The Government of Canada was kind enough to pay me a lot of money to look at it for a couple of years, and the least I can do is comment on it.

If you look at culture in terms of the narrow interests of so-called cultural industries, then, except for magazine postal rates, the government lived up to its commitment not to have culture on the table. You may remember that when cultural industry leaders — moguls of the broadcasting and so-called cultural world — created a committee in the middle of the negotiations to oppose the agreement, Bob Fulford wrote a piece in *Saturday Night* talking about how nauseated he was by the hypocrisy of these people. "Private broadcasters", he wrote, "who have made millions mainly by importing cop shows and situation comedies from Los Angeles, have been transformed into born-again nationalists, even anti-Americans". The possibility that free trade with the United States would alter or eliminate culture or protectionism and subsidies brought them together and, of course, in our report we demonstrated clearly that, in fact, it was state aid to private broadcasters through Bill C58 and simulcasting that earned them — in the last year, for which we had figures — \$100 million dollars they otherwise wouldn't have had in profits. And in return for that, they showed more and more American programs on their Canadian stations.

I suppose, then, this agreement is a victory for culture in some sense — forgive me if it's not in my sense. As to what the document says about culture in other senses, let me bore you with some more quotations.

The American document says that "the Canadian cultural industries are exempt from the agreement, provided the exemption will not impair the benefits that the United States would otherwise expect from the provisions of the agreement". The Minister of Communications, Flora MacDonald, has pooh-poohed this American interpretation, and she offers her own interpretation, which I'll read now.

"Notwithstanding any provision of this agreement, a party may take measures of an equivalent commercial effect in response to

actions that would have been inconsistent with this agreement." Now, aren't you happier with our words than theirs? If anybody in this room understands three words in either of those, I will happily pay you money to sit down with me later and tell me if culture is in their hands. Dick Lipsey is willing. I welcome you and it is worth a \$1,000 an hour, because this gobbledegook means nothing to me. So whether cultural sovereignty is preserved or demolished is beyond me to understand at the moment.

I want to talk about sovereignty and culture in a rather larger sense. I want to talk about it in terms of the values of a culture, rather than culture in its narrow sense of broadcasting and films. It seems to me that the real question of sovereignty for us — for all Canadians — is the kind of country we want to have. I share Jo Surich's admonition that the battle of who is the greatest patriot is not an edifying one for this community. I don't doubt the patriotism of anybody on the other side and I know that the accusation that the Surich side is against change, which someone accused him of today, is simply not true. The question is what kind of change one is for. The labour union side and my side are for a great deal of change. I think that is the essence of the conversation and that's what puts me on the "no" side of this debate. I believe that many of the spokespersons for free trade are trying to peddle an American individualism; a set of values, in my view, that is inappropriate for Canada. I find them inappropriate and frightening. It is all about how tough we have to get and how we have to be tough to compete in the tough international market place.

Michael Wilson talks about the confidence we have to have in ourselves and in our future. He says, let's move beyond small Canada, let's move beyond narrow horizons. I want to tell you, it sounds like the pep talk in the locker room before the big game. It is a kind of a John Turner way of saving the world of jock economics for a jock capitalism. That may be terrific for rugged individualists, but it is not about the kind of consequences I want for this country. But I also believe, from private conversations with businessmen, that that's what they love about it. They want to get in there and they want to go toe to toe with the Yanks. I don't think that's where I want to go. I don't think that's what I want to leave this country.

I fear what kind of Canada these rugged individualists might want for us, and I will tell you what came to mind as I tried to think it through preparing for this session. Right after the 1984 election, after the great Mulroney victory, there was a euphoria of almost unprecedented magnitude in the business community; it was like a perversion of William Wordsworth. Remember the phrase, "It was bliss to be alive in that dawn, but to be a business man was very

heaven"? As a result, there was an outpouring of what some people were happy to see was the real agenda of the business community when they thought that, at last, they had gotten government that was true to their own interests.

What it unleashed were certain unpleasant propositions. Everything I am going to say now is factual and comes from documents from the people I am going to quote. It was the Royal Bank of Canada in a presentation to the Macdonald Commission that suggested if minimum wage laws could be relaxed, more jobs could be created. This was at a time when minimum wage laws in most jurisdictions of the country didn't amount to \$4 an hour, under \$8,000 a year. The Royal Bank thought it would be good for business if that were even lower.

The Canadian Chamber of Commerce wanted unemployment insurance benefits for the sick and for pregnant mothers to be cut off, because it was bad for the market place.

The Canadian Manufacturers' Association, in written documents and in public press conferences, wanted to relax the laws that applied to holidays, minimum wages, health and safety standards, protection for children.

This is all real. They recommended a guaranteed annual income of \$7,000 for single people and \$10,000 for families to replace all the other benefits that were available. Well below Statistics Canada's own figures for poverty and all of it was in the name of the market. All of it was in the name of the same market for which some of these same people cheer free trade — the market-driven economy which will somehow provide? I will tell you, I am too dumb to understand. Why in heaven's name it is okay to do that individually, for personal gain, but it is some kind of crime against justice to do that collectively for collective gain, is something that I have never understood.

We are not talking about all sorts of capitalism. We are talking about a North American brand; we are not talking about Japanese capitalism and we are not talking about a system that seems to work in Sweden, Austria, or West Germany. We are talking about a specific American, United States American, view of the market that Canadian business people have gotten sucked into, in my view. And so has the government on behalf of whom much of business is fighting to get this agreement.

I ask the same question. Are the values of the Government of Canada mine? I agreed with what Dick Lipsey said this morning. The reason that the government must have a public adjustment assistance program is because no one trusts this government without it. And I don't trust this government without it. This is a government that

wants to rejuggle the efficiency of the postal system by making a whole lot of Canadians earn \$6.00 an hour. That's \$12,000 a year. I don't think that is a proper value and I am sorry that Grant Devine is not here because I want to know what he and I have in common. He has led a counter-revolution in Saskatchewan to dismantle the welfare state, in a systematic and deliberate way. It must be terrific for the market, but it's hell for a whole lot of people in that province. I want to say to you that that's not very satisfactory to me and, if such people think the free trade agreement will help facilitate those kind of values, rejigging the other Canadian values for those kind of values, I for one want nothing to do with it.

I believe there are other things to fight for. I want to be able to fight for the kinds of changes I believe will make this a more decent society, for a better redistribution of economic and political power without knowing that there is no chance whatsoever for such changes to come about in part because of the free trade deal. I want to know that the next Government of Canada is free to introduce a program if it chooses to, that is not constrained to begin with by an organic integration in the North American economy that precludes substantial change. I do not expect miles of manoeuvring room; anybody on my side who does is being foolish. But I expect enough room that the sovereign right of a government to try to introduce a reasonable, progressive program is not constrained from the beginning. I do not want to enhance, institutionally, the chances of the market agenda becoming dominant in this country.

So my position is simply that I think a market-driven machismo-oriented free trade deal that binds Canada for the future is all right for some people. But it is not all right for me. And it is not all right for a whole lot of people who will suffer because of it. I believe we should reject the deal so that Canadians will continue to have the right to fight for something that is more humane and more decent than I believe can be possible under this agreement.

Cultural Sovereignty and Free Trade

Ivan Bernier

Few issues in the history of Canada, it has been pointed out, come as close to rivalling the linguistic question for both longevity and vehemence as the question of free trade with the United States. It is probably not by sheer coincidence that both questions also have something to do with culture. The fact is that if we look back at previous attempts to realize free trade, particularly in 1911 and 1948, when the project of an economic association with the United States came closest to succeeding, it is indeed the more emotional argument, the argument of cultural identity, that appears to have won the day. This, perhaps, explains why, in the Macdonald report that came out in 1985, the recommendation was made that Canada pursue a more aggressive policy of support for indigenous cultural expression as a concomitant of a bilateral trade initiative.

Even now, however, as we are approaching the moment when we have to decide whether to go ahead with the free trade agreement just negotiated, one of the most fundamental objections to it still has to do with the impact it will have on Canada's cultural identity and sovereignty. Unfortunately, the debate on this particular issue has not been very satisfactory, a great deal of ambiguity surrounds the three concepts of cultural industries, cultural identity and cultural sovereignty. I shall, therefore, attempt to clarify some of this ambiguity by discussing the cultural industries themselves, then examining the issue of cultural identity and finishing with the question of cultural sovereignty as such.

Free Trade and the Cultural Industries

The basic facts regarding Canada's cultural industries are well known, the importance of the penetration of the Canadian market by American products well established. According to the report of the film industry task force, set up by the federal Department of Communications in September 1985, 97 per cent of profits from Canadian theatrical distribution went to foreign — mainly American — companies in 1981. In practice, the report says, "the American industry considers Canada to be part of its domestic market. When it acquires American distribution rights for a film, it insists on Canadian rights as well".

Despite such a near total domination of the distribution market, however, the screen-time devoted to Canadian films in 1984 was less than 2 per cent. In that year, only one such film was released by the majors. In the book publishing industry, figures quoted by the Minister of Communications in July 1985 tend to show that only 18 per cent of the English-language books sold in Canada came from publishing houses controlled by Canadians; the figure for French-language works is 26 per cent. Yet, with barely 20-25 per cent of the revenues emanating from the domestic market, Canadian publishing houses are responsible for close to 80 per cent of original works by Canadian authors, and they export considerably more than foreign-owned companies.

In the sound recording industry, finally, a very similar situation prevails: the foreign-controlled companies earn the greatest part of the industry revenues while devoting a much smaller proportion of these to the sale of Canadian content recordings than their Canadian counterparts. Whether one can describe such a global situation as critical, as does the film industry task force report, remains to be seen.

The reasons for this are equally well known. The first reason is the low cost of American cultural products in Canada, the production costs having been largely absorbed in the United States. This has given rise to what has been called by Hyman Solomon of *The Financial Post* a situation of competitive imbalance. In some instances also, the vertical integration of the industry has helped in the penetration of American products, a phenomenon specifically obvious in the film industry where we have, one could argue, a problem of fair competition. A case launched in the 1930s under the Combines Investigation Act failed before the courts for reasons having to do with the lack of criminal intention. Another case has been launched last year by a small Quebec film company against Famous Players and

Cineplex Odeon for the reason that the company could not get screen time for a Canadian film at acceptable periods.

Another explanation is that American production is diversified. There are some very costly products there that we can't emulate here. When we enter into such considerations, however, we are on dangerous ground. Some people will say that it is not necessarily better or it's not something that we can measure.

What have been the Canadian reactions to this situation? Since 1927, various Commissions, task forces, working groups have been set up to consider the difficulties of the Canadian cultural industries. They have consistently recommended the adoption of policies designed to ensure a significant and dynamic Canadian presence in the field. In support of these recommendations, various arguments have been put forward. Some of them are nationalists in outlook, as in the Massey Commission report; others have a market approach basis. These arguments have been severely attacked, however, by neo-liberal authors such as Steve Globberman, or Jean-Luc Migue in Quebec, and also by the Fraser Institute in B.C. Their criticisms raised some very good points, as when they question the notion of cultural products having a distinctive Canadian identity. That presupposes some kind of general consensus about that identity and those qualities that are linked with that identity. Unfortunately, such consensus is far from obvious and the exact proof of it is difficult to find.

At the same time, their criticisms appear flawed in that they do not answer the fear of those who consider that what is at stake is the very existence of a Canadian cultural sector. The most fundamental and valid argument to justify Canadian intervention has precisely to do with the maintenance of a viable Canadian cultural sector in Canada.

What have been the Canadian actions to protect that cultural industry? We can regroup them in various categories. The first group has to do with protection of revenue sources, such as Bill C-58. The second group includes those measures that provide for financial help and subsidies for Canadian industries. The third group concerns quotas, the Canadian programming quotas for television determined by CRTC, for instance. The fourth group concerns the control of investment. Under the *Investment Canada Act*, cultural industries are excluded: they remain the object of special review. Fifth and last, there are measures designed to break American domination of the distribution system. There are not many of those. The only example is the Quebec approach in its *Loi sur le Cinéma*. A Canadian bill is supposed to copy, to some extent, that approach, but it is still on the drawing board.

What has been the American reaction to those Canadian actions? Basically, the Americans have said over and over again that what they export is just entertainment and not culture. That raises a serious problem. When we discuss this topic with them, there is a misunderstanding right at the beginning. They talk about entertainment, we talk about culture, and there is apparently no way the two can understand each other. Apart from that argument, the Americans, during the negotiation, have made it very clear that culture had to be on the table. Mr. Murphy, Mr. Yeutter, Mr. Schultz have said so many times and that makes us think that culture must indeed be important. Canada for its part has responded by asserting that its cultural identity and cultural sovereignty were not negotiable. So then, what has been negotiated? We have now some indication of that in the preliminary transcript of the free trade agreement between Canada and the United States.

Culture was obviously on the table, if we judge by the proposed agreement: there is a whole section dealing with cultural industries. The basic principle admittedly is that the cultural industries are exempted from the application of the agreement. But the freedom of action of each government in the area is itself limited and constrained by the authority they are granted to retaliate against measures adopted by the other that are incompatible with the agreement. Cultural industries are also in the agreement in the sense that, as all duties will come down, the few remaining duties on cultural products will also be eliminated gradually.

If we accept, nevertheless, that cultural industries are exempted, a further question arises: Does GATT still apply to them? I find that an interesting question. If the cultural industries are not part of the agreement, where are they? They must be under the GATT. You are not allowed to retaliate just like that so the problem becomes: To what extent is the retaliation right granted by the agreement compatible with GATT?

Cultural industries, as described in the annex, do not include printing and typesetting. I think we have to keep that in mind when we talk about cultural industries. Canada also undertakes, under the agreement, certain duties in the cultural field. The first one is to revise its copyright law to provide protection to the retransmission of copyright programming. This was presented as a matter of fairness, but it is nevertheless an expensive undertaking. The figure that circulates is that it will cost Canada something like \$70 million to \$80 million. Another undertaking is to remove the "print in Canada" requirement for eligible advertising expenses that can be deducted for income tax purposes. Here we can say that it really doesn't

concern cultural industries as such. The last obligation is to phase out discriminatory postal rates for magazines of significant circulation. That is a fairly old practice, and its disappearance will probably have a limited impact. The margin of preference is only 1.5 cents, and it will be phased out gradually.

In return, Canada gains the exclusion of cultural industries from the application of the rules dealing with investments. This is subject to the obligation to offer fair compensation in the event that Canada requires the divestiture to Canadians of U.S.-controlled business in a cultural industry. Here again, we can raise the question whether this was necessary considering the basic principle enunciated before that cultural industries are exempted from the application of the agreement. Why is this added now? Probably to introduce a fair compensation consideration. However that may be, this is an important gain for Canada considering the previous American attitude as illustrated by the Gulf-Western/Prentice-Hall episode of a few years back.

What evaluation can we make of the various rules concerning the cultural industries that are to be found in the agreement? We are very close to the status quo in a sense. We do undertake certain special obligations, but at the same time we establish our right, notwithstanding the agreement, to keep our cultural industries Canadian. There are some problems that have not been dealt with, such as the question of split run editions: it is very difficult to say whether the Canadian prohibition will remain because this is a kind of quantitative restriction which, under the agreement, cannot be maintained except in accordance with GATT; and it is far from clear whether it is compatible at all with GATT. So that is about all there is to say on the cultural industries as they are considered in the projected free trade agreement.

The Canadian Cultural Identity

Now what about the Canadian cultural identity? Notwithstanding the basic exclusion of cultural industries from the agreement, there are still fears of loss of cultural identity, and they obviously are not about to disappear. Now what is the exact nature of these fears? The first answer is that the agreement will bring Canada closer and closer to the United States with a unifying impact on our values and way of life. However, when an attempt is made to determine the precise nature of this argument, difficulties quickly come up. What are the distinctive Canadian values and to what extent is the Canadian way of life different from that of the United States? There are probably

answers to those questions. I would have some, but they are essentially subjective, as would be those of any other person.

It is hard to say whether we could ever reach full agreement on what those Canadian values are. Just to illustrate the problem, I would like to quote Calgary Herald publisher J. Patrick O'Callaghan from a public speech given in 1986:

"Of all the possible impediments to a free trade agreement, it is the concern over cultural identity that haunts me the most. What culture do we have that is so distinct, so fragile, so valuable in historic terms, that we allow it to become the focal point of an agreement that can determine whether or not Canada achieves its growth potential in the decades to come? How many reruns of Wayne and Shuster do we have to endure? How many times can you expect Canadian movie-goers to be exposed to Mon Oncle Antoine or Maria Chapdelaine? And if it comes to a choice between Porky's and our survival as a trading nation, I know which I would choose."

I mention that because I see some difficulty in arguing that there are very specific Canadian values and a specific Canadian way of life that should be preserved at all cost. It would certainly be a difficult task to define what exactly we are trying to protect. Furthermore, even if we accept that there are some American values that are carried over into Canada with the cultural products exported, there is still the problem of finding out how those American values are received. If they are received not in a passive way, but actively, critically, the impact may not be as great as is sometimes claimed. Unfortunately, there are not that many studies on the question. We definitely have to know more about that. At the level of values, therefore, it is difficult to build a strong argument.

But there is another way of formulating the problem, of explaining the fear that exists. If one accepts the extension of the concept of culture to include in it the way the state intervenes in the society and the economy, to include, in other words, the great diversity of laws and regulations that decide the way we function politically and economically, that reflect our priorities in social terms, the compromises that have been realized between various interest groups, and so on, then it is indeed possible to say that free trade will inevitably affect our cultural identity. The elimination of obstacles to trade, the harmonization of legislation in such areas as subsidies, services, health and security regulations, the inevitable search for common attitudes regarding the role of the state in economy, will definitely exert pressures to conform to American competitors if we don't bring our laws more in line with theirs.

I believe that we are kidding ourselves if we think that there won't be any pressure to conform. It may be argued that the pressure is already there, as some studies have shown, and that a simple free trade agreement will not modify that situation substantially. But that is correct only if we assume that the proposed Canada-United States Free Trade Agreement is exactly that, a simple free trade agreement, and does not evolve toward a common market structure. My personal view on this is that diversity is of the essence of trade and that any attempt to become a duplicate of the United States will be totally wrong. I think we would be losing our competitive advantages in acting like that. We have to protect our own distinctive way of approaching the problems of the Canadian economy and the Canadian society, provided this is not a pretext for discriminating against others or trying to protect our own producers.

The Canadian Cultural Sovereignty

I now come to the cultural sovereignty argument. Pushed to its limits, the argument regarding culture is sometimes expressed in terms that make you think that absolute power to act without limitation should always be retained. I have here a quotation from the Minister of Communications in 1985, Benoit Bouchard, who said: "We believe that, just as retaining our territorial sovereignty is essential if we are to remain an independent nation, so it is true that we must always retain our cultural sovereignty — the absolute right in the eyes of the world to use all the instruments at our disposal to enhance and defend our unique identity." I find it difficult to accept this notion that there is an absolute capacity to act that we must retain at all times. The whole of international law is based on the premise that sovereign states, when they sign agreements with other states, are not restraining their sovereignty, they are exercising their sovereignty. So the whole problem comes back to deciding what there is in this agreement. Is it something that is worthwhile? Is it something that may constrain us, but at the same time, something that will benefit us, something that we want to obtain? If that is the case, it is not truly a limitation on our sovereignty but rather a deliberate exercise of it.

What I would like to say in conclusion is this. There is indeed, in my view, something to gain in this agreement. Furthermore, we do not have much choice. I believe that we have to go ahead, but, at the same time, I would suggest we have to exercise a great deal of care in order to make sure that we are not moving toward something that is quite different, something that we do not want.



A Balance Sheet on the Free Trade Agreement

Abraham Rotstein

About three decades ago, the English novelist, C.P. Snow, published his famous essay entitled "The Two Cultures". It highlighted the growing rift that was developing between the scientific community on the one side and the humanist and artistic community on the other. These two communities had different visions of the world and were using different languages and so they could hardly communicate anymore. As a result they developed a mounting suspicion and contempt for each other.

I suspect that as the free trade debate is heating up in this country, we are developing our own version of "the two cultures". The two camps have different visions of the Canadian future, are developing increasingly belligerent postures and rhetorical phrases, and are questioning each other's bona fides. Both sides agree that the issue is absolutely vital to the future of the country and both claim to have the vital interests of the country at heart.

In the free trade camp, I detect a euphoria usually reserved for evangelical religions — a vision of a born-again Canadian economy in the making.

In the anti-free trade camp, it seems that some are afraid that the San Andreas fault is part of the free trade package; that the fault will be moved north to the 49th parallel and that the country will tumble in.

The impassioned rhetoric is understandable when so much appears to be at stake. But it would be a pity if we lost a common language of discourse and continued to shout right past each other.

I am at least as partisan in this debate as the next person, as many of you are aware. But I wonder whether there isn't some simpler, more neutral language that we can employ that will be understood by

everyone. I would like to comment therefore, not on the deeper philosophical issues that surround free trade — which will get us off and running again — but simply on the terms of the free trade agreement itself. What can we say about this agreement strictly as a business proposition?

The first point to be made is that the free trade agreement can best be understood not as a single agreement but as two different agreements that are yoked together in one package. Two different, and in some ways incompatible, strands crisscross each other and together constitute the basis of the Canada-U.S. Free Trade Agreement. I will therefore try to regroup the main elements under two headings: those that have to do with tariffs, and those that have to do with non-tariff barriers. I will necessarily leave out a few secondary features of the agreement, but perhaps this procedure can help in the appraisal of the soundness of the agreement as a business deal.

The age of tariffs has, for practical purposes, come to an end. It died a slow and gradual death in the several GATT rounds of the post-war period, where trade liberalization produced many clear benefits for Canada. It did not need the latest free trade agreement to give the coup de grace to what remained of the tariff wall between Canada and the United States. Much of the work had already been done in the latest GATT round, the Tokyo Round, that was completed in 1979. Here 90 per cent of Canadian exports could, after the end of 1987, enter the United States at a duty of 5 per cent or less. At present, about 70 per cent of Canadian goods already enter the United States duty free. Few Canadian goods face a tariff of any importance; the exceptions could be counted on the fingers of one hand. These include notably urban mass transit and petrochemicals.

The present free trade agreement provides for the finishing touches to such "free trade" in the classical sense, by proposing to eliminate all remaining tariffs within a 10-year period. How are we to appraise, therefore, this first segment of the free trade agreement?

Although there is something to be said for this proposal in its own right, the benefits are uneven. The United States benefits disproportionately, since our remaining tariff wall was, on average, twice as high as that of the Americans. The greater difficulty however is that we lose the sanctions that made the Auto Pact effective. While the new agreement proposes a 50 per cent North American content rule for cars that are sold here, it is not clear how Canada will be assured its share of that 50 per cent. Some point to the growing efficiency of the Canadian auto plants and others to the lower Canadian dollar to give us all the assurance that we need. But the 75 cent Canadian dollar may take an upward turn as the U.S. dollar falls lower in

relation to the world's currencies. This may undermine the present levels of auto production in this country. If a set of safeguards could be found that would serve as a functional alternative to the old safeguards that relied on tariffs, then we could usher out the last vestiges of the tariff wall with good grace despite the American advantage in this portion of the agreement.

The recent celebrations of the agreement in the free trade camp are really a belated paean of praise to the last GATT round where most of the work was done. Only some finishing touches were added while the automobile problem was left in a precarious limbo.

If the present agreement had been limited to this final step of tariff removal on both sides, if it had, moreover, provided new but effective safeguards for our share of automobile production, I expect that there would have been little fuss made about this final step toward "free trade". There would however have been little that was new to celebrate.

This brings us to the second part of the agreement, the attempt to deal with the numerous countervail, anti-dumping and injury suits that American firms have brought against their foreign competitors. This was in fact the heart of the Canadian concern: to receive some exemption from this trade remedy legislation and achieve "secure access".

While tariffs can be negotiated so to speak with a "common currency" namely some agreed-upon percentage reduction of the tariff on both sides, non-tariff barriers have no such common denominator. We enter instead a new realm of negotiation, a form of barter of fairly large and discreet items that cannot easily be weighed one against the other.

Two questions come up on this part of the deal: What did we get, and what did we pay for it? To take the latter point first, the list is well known and I review it only briefly:

- a major reduction in control of incoming foreign investment. Below the new level of \$150 million we will no longer have the right to monitor its performance, insist on provisions for local content, local sourcing and so on.
- the creation of a continental energy pool giving up the right to set different prices on our exports, create adequate reserves for future domestic needs or use our energy to special advantage as part of some future industrial program.
- major concessions in the area of services. To take only one corner of this, namely financial services, the deal is quite asymmetrical with some hypothetical assurances about how we will be treated in future legislation. "It's quite clear what we've given up" says Lynr

Buckle, vice-president and director of the Canadian Bankers' Association, "It's not clear what we're getting in return."

I have already mentioned the loss of the safeguards on the Auto Pact. We have been given some assurances on the protection of regional development programs and cultural programs, but we have been given no clear indication as to what mechanisms will operate to guarantee the exemption from countervail in these latter areas. As long as we remain without a definition of what constitutes a subsidy and as long as the Americans insist on the primacy of their countervail law, it is difficult to see how the Canadian government's assurances in this area will actually work.

The review process with its panels and its binding features is both novel and welcome. It has been hailed with misplaced hyperbole in the free trade camp ("envy of the world" and so on). But its mandate is simply to see what American law is correctly applied. Politicized decisions in the area of countervail and anti-dumping are the exception rather than the rule. The problem does not lie in the lack of objectivity in the application of these laws by American courts. The problem lies in the laws themselves. After the joint tribunal has given its verdict, we will simply be putting the Good Housekeeping Seal of Approval on the mainstream of American countervail actions.

Will the free-trade agreement give us relief on shakes and shingles? Relief on potash? Relief on softwood lumber? The answer is an unequivocal NO. Will it exempt us from the new omnibus trade bill that is in the offing? Despite the brave noises that are made on this side of the border, the answer is once again NO. The most optimistic verdict that we can give in regard to exemption from future harassment is to quote the late Samuel Goldwyn: "I'll give you a definite maybe."

The reply at this point is generally that down the road, say in five to seven years, we will have worked out a common code between the two countries. The first point to note is that the reason we didn't do all this negotiation through GATT where we have generally been far more comfortable and far more successful, is that it would take too long. On the crucial question of a common code, it now appears that it will take no less time on the bilateral route.

What are the chances for success? By that I mean the chances of arriving at something other than existing American countervail laws as the common code for the two countries. Not very good I suspect. At this last stage, we will have given all our bargaining chips away — except perhaps for water — and the costs to the Canadian economy of cancelling the agreement and backtracking will be enormous. The

Americans will have us over a barrel and we will gracefully incorporate the American rules I suspect and call it the new common code.

So there you have it. Put yourself in the position of a business executive. Somebody brings in for your signature a two-part agreement. In the first part on tariff concessions, you give away twice as much as you get and lose, moreover, the production safeguards on the Auto Pact that apply specifically to Canada.

In the second part of the agreement you make major concessions on investment regulations, energy, and services. What do you receive in return? The assurance that you can appeal a countervail decision where the law is unfairly applied but cannot get that law itself amended or exempt yourself from its application.

I ask anyone who has ever had to negotiate and sign a business deal: Does this add up? Is there even a remote degree of balance between what you are giving up and what you are getting back?

I hope that people in the business community and in the government are going to pose some hard questions about these "terms of trade". In contrast with this feeble proposal, stand the major achievements of trade liberalization that we achieved under GATT. GATT was, and still is, in my view, our best option.

What will our other trading partners think of this agreement? Any Canadian exemption we do achieve will result in other countries being hit harder. William R. Cline, Senior Fellow of the Institute for International Economics, puts it as follows: "A Canadian exemption has to come out of someone else's hide". This free trade agreement, I fear, is likely to give free trade a bad name.



Sovereignty and the Canadian American Free Trade Agreement

Richard Lipsey

Before going into details let me make four preliminary points.

First, the purpose of international agreements is to constrain sovereignty. Probably the most successful international agreement ever seen in the field of trade is the General Agreement on Tariffs and Trade in which each country gives up their sovereign right to alter tariffs in ways that they would wish to do were they not signatories. We went to the bargaining table with the U.S. in order to agree on mutual restrictions; it follows that it is no criticism of the agreement to say it restricts Canadian sovereignty. The appropriate question is, "Did the restrictions each country accepted on its sovereignty constitute a mutually beneficial package?"

Second, there has been so much hype about Canadian sovereignty that few Canadians have even noticed what the United States has done. The historical tradition in the United States has been to avoid restricting its sovereign right to make its own decisions by subjecting them to any independent international review process. In this agreement the U.S. has made an historic concession — and one that they resisted until the 11th hour. They have agreed that their sovereign right to determine the need for countervail and anti-dumping duties on Canadian imports is to be subjected to a binational review process that the legal experts who spoke at this conference tell us will be much more objective than the present unilateral procedures.

We got something the world would love to have. Talk to people in Japan and Europe and you will find we are the envy of the world. Listen to the Canadian media, however, and you would think the deal was a sell out. Apparently they feel that preferential access to the U.S. market and some U.S. concessions of sovereignty on dispute settlement are worthless. To be clear we did not get all we wanted — no one

ever does in international negotiations. But we did get a constraint over American sovereignty so that a binational panel can judge the fairness with which Americans have applied their own laws. Among other things this protects us from a de facto loss of sovereignty implied by the ability of the United States to attack our exports for reasons that have little to do with trade distorting policies — as they did in the 1986 softwood lumber case.

A final evaluation of the dispute settlement part of the agreement must await the final text and its interpretation by lawyers. In the meantime two things stand out to me.

- The present agreement is vastly better than the status quo on countervail, anti-dumping and escape clause action and should not be thrown away lightly;
- We have got a living agreement (if we do not kill it at birth). It is one that will evolve in creative ways to give each country more and more security of access over a broader scope of goods and services as time goes by.

Third, it is important to note that strong harmonization pressures exist in the status quo, so that the effect of the Canadian American Free Trade Agreement (CAFTA) must be assessed in terms of how it *changes* these pressures. This sounds obvious, but 97 per cent of the hysteria to be heard on this issue concerns worries — often genuine enough — about the status quo, not about the changes that a CAFTA would cause.

Finally, note that there were two types of harmonizing pressures. One type is expressed through political channels at the bargaining table, and the other is expressed through the operation of economic forces after the agreement had been signed. In the rest of my comments I shall deal with the pressures separately.

At-the-Table Pressures

Social Policies

A year ago, the issue was whether or not Canada could even risk going to the bargaining table. Opponents said that the U.S. negotiators would ask Canada to give up so much on social policies that it was too risky even to begin to bargain. Supporters maintained that the only way to find out whether these fears were justified was to sit down at the table and try. Canada tried, and the fears have proven

unjustified; the agreement does not even mention Canadian social policies.

Culture

On culture, some opponents feared that negotiating with the United States would mean that Canadian cultural policies would be bargained away. Instead, cultural industries have been broadly defined, and almost totally exempted.

Subsidies and other measures to support culture as narrowly defined were never at risk. Operas, symphony concerts, jazz festivals, and publication subsidies to Canadian authors, and Canadian learned journals, were never even discussed. Favourable tax treatment for film makers also seems to be still acceptable.

What was discussed were the mass cultural industries, such as radio, television, and publishing. But even here, many Canadian measures, such as Bill C-58, escaped completely. The three negotiated changes are relatively minor.

First, the agreement removes the modest differential in the postal subsidy on high-circulation U.S. magazines. Author Margaret Atwood surely exaggerates when she says, "There go our national magazines." Most foreign magazines, including U.S. magazines, are still subject to a much higher postal rate. My soundings lead me to expect no significant effects from this change.

Second, the agreement ends the use, without payment, of U.S. and Canadian television signals by Canadian cable television companies. This practice, which some have called international piracy, needed to be rectified. Surely, it is in Canada's self-interest to move toward rational rules to protect intellectual property at the international level. All countries gain when the rule of law is imposed internationally.

Third, Canada has agreed that if it forces divestiture of indirect acquisitions of Canadian subsidiaries in the cultural area, the subsidiary is to be sold at fair market value. Could any fair-minded Canadian disagree? The agreement allows Canada to retain the right to force such a divestiture. I am not certain that this is a desirable policy, but, for what it is worth, Canada has retained it.

When all the hype about Canadian culture is discounted, precious little was given up. It is hard to believe that the Agreement will affect any significant piece of Canadian culture one way or the other. By demanding — and getting — exemption from the agreement, members of the Canadian cultural community have also denied them-

selves the benefits. While business and trades people will be able to cross the border more freely in pursuit of new business activities, musicians, dancers and actors will continue to suffer the present serious restrictions on temporary entry to the U.S. One can only be impressed with the altruism of Canadian performing artists who gave up what must have been a dream for many — vastly improved access to U.S. engagements — in defence of the profits of two owners of radio and T.V. stations who are the main beneficiaries of measures such as Bill C-58.

Foreign Investment

Much of the rhetoric on this issue belongs to the 1960s. Today, Canada is home to many of its own large multinationals. Furthermore, for several years, the annual flow of Canadian direct investment into the United States has exceeded the flow of U.S. direct investment into Canada. As a major foreign investor, Canada has a stake in achieving national treatment of its investments in other countries.

The agreement commits both countries to national treatment with respect to future policies while retaining Canada's ability to review the large direct acquisitions that are the ones that become objects of national concern. Considering the great concern in the United States to regularize the climate of foreign investment, and considering Canada's own long-term interest in doing so, this looks like a mutually advantageous concession.

Almost unnoticed, and before it becomes an issue, the agreement gives national treatment to *Canadian* investment in the *United States*. This safeguards Canada from the United States' doing to us in the 1990s what we did to it in the 1970s. It is a forward-looking achievement, of great potential value.

Energy

We must wait for the final text to see what has really been achieved on energy. For example, the supply-sharing arrangement requires further clarification. Supporters in western Canada and Quebec, however, believe that the agreement helps to improve their access to the U.S. market. Critics argue that Canada has given up an important policy lever it might wish to use in the future.

The agreement seems to provide a very soothing balm to the sores created by the National Energy Program. It provides an important guarantee to the energy-producing provinces that the federal gov-

ernment will neither restrict exports to the United States by more than an agreed formula in the event of a shortage, nor set domestic energy prices lower than those at which energy is exported to the United States.

Canada cannot expect the United States to accept free entry of Canadian energy in times of glut while reserving the right to turn off the tap in times of shortage. If Canada wants to reserve the latter right, it also must deny the West and Quebec the former privilege.

Canada has agreed not to sell energy domestically at a price lower than in the United States, which effectively means not below the competitive price in North American markets. If Ontario and other eastern provinces reject this, they would be saying, in effect, that they are prepared to let the West bear the brunt of the recession caused by low world energy prices but, if world prices recover, they reserve the right to appropriate much of the benefit by forcing the West to sell below world prices. That sounds like heads the East wins and tails the West loses. On the surface, that attitude would seem divisive to national unity.

If the energy part of the agreement is rejected for good national reasons, the West will probably swallow the pill, however bitter. But if it is rejected for reasons that make no sense in national terms, without even bothering to acknowledge the claims of the West and Quebec for access for their energy exports, serious regional rifts are likely.

It is worth noting that the agreement does not preclude all sorts of energy policies: exploration and development can be encouraged, the rate of extraction can be controlled, and taxes can be imposed, either at the wellhead or on the consumer. What the agreement does preclude is the use of tax or trade policies as a tool to discriminate in favour of domestic consumers of energy as compared with U.S. purchasers.

Post Agreement Pressures

Social Policies

Now that the agreement exists, its opponents have shifted their argument to the policies left untouched by the agreement. They now say that Canadian social policies are too costly to be maintained in the face of free trade, implying that liberalized trade will lead to a forced harmonization of social policies. Roy MacLaren, publisher of *Canadian Business*, puts it this way:

"One cost of doing business is taxation. No Canadian would be so naive as to believe that Washington would amend its tax laws to conform with Canada. So Canadians would then urge Ottawa to make Canadian tax practices conform with those of the United States, even more than they already do. That a comparable tax system (and soon thereafter monetary union) should be seen as an essential element in a successful free trade area may sound reasonable, but it means in essence that taxation would be decided in Washington, not in Ottawa. That different levels and types of taxation are necessary in two different countries would be ignored.

"If Canadian social programs such as medicare, pensions, regional incentives and environmental protection could not then be adequately financed, so much the worse. Those programs should then be changed to conform with U.S. practices.

"But that is not all. Since taxation without representation is anathema to all right-thinking democrats, it would presumably occur to some Canadians sooner or later that they should be represented at the place where tax policy was being made, i.e. by seeking to elect representatives to the U.S. Congress."

The issue can be discussed on two levels, theory and practice.

In practice, the evidence does not support the contention. For example, Sweden's social policies are more generous than those of other European countries, yet Sweden trades successfully with the European Community without tariff protection. Belgium and Holland have social policies that differ from each other profoundly in their scope, cost and tax implications, yet they have a customs union that predates the European Community. The 72 countries currently involved in free trade areas, or common markets, have not harmonized their social policies completely, nor have Canadian provinces, nor have U.S. states. Furthermore, since Canada has removed most of its tariff protection since 1935, it already should have been pushed most of the way toward policy harmonization. I can only urge those who believe that completing the process of tariff reduction will suddenly unleash vast harmonization pressures, not now felt, to explain how this will occur.

To bring theory to bear on this issue, one needs to distinguish between policies that generally raise costs, and those that change relative advantages. Only the latter lead to harmonization pressures. For example, people can migrate in response to high marginal rates of income tax, and this sets up harmonization pressures. However, these pressures need not be given in to fully. The United Kingdom, for example, ignored these pressures, kept its high tax rates, and

accepted the loss of actors and pop groups who left for lower tax jurisdictions. Such harmonization pressures exist between any two jurisdictions, and they are stronger the more mobility there is between the two. That they do not force complete harmonization is shown by the evidence of Sweden, and scores of other countries.

The relevant issue is how these pressures will change by trading with zero tariffs versus trading with the modest tariffs we now have. The apostles of doom need to explain how Canada has so far been able to maintain the policy independence they seek to preserve while Canada was removing the bulk of its tariffs between 1935 and 1986.

On policies that affect across-the-board absolute costs — such as unemployment insurance or universal hospital and medical care paid for through higher taxes — the theoretical refutation of the harmonization argument is found in the first chapter of any textbook on international trade. It is a proposition that even the severest critics of trade theory have not tried to upset. *Trade depends on comparative, not absolute, advantage.* High-cost countries can, and do, trade effectively with low-cost countries. The mechanism that allows this is the exchange rate. If country A finds the money costs of all its goods higher than country B's money costs, adjustment must follow. A's firms and households will sell nothing to B, and will try to buy everything from B. As a result, A's currency will depreciate until A can sell some goods to B, while buying other goods from B. This is no untried theory; it is tested every time one country's currency inflates faster than another's, while its international competitiveness is preserved by a depreciation of its currency.

The application of the Canadian-U.S. case is called the "border tax adjustment theory". It arose over the controversy about the effects of the EC's value-added tax, which was remitted at the border. An unfair export subsidy, said the vocal U.S. critics; not so, said one of Canada's greatest economists, the late Harry G. Johnson, in a now classic article that seems to have settled the issue. If a general social policy, such as unemployment insurance, raises costs across the board, it does not destroy competitiveness. Instead, it depreciates the currency. Thus, a flexible exchange rate ensures that, if we want to, Canadians can maintain more generous social policies than does the United States (and the higher taxes that go with them).

Of course, no analysis is final, but knowledge progresses by locating the error in prevailing beliefs. Surely the people who so confidently assert answers to the harmonization issue should feel some modest obligation to tell us where Adam Smith, David Ricardo, John Stuart Mill, Karl Marx (who accepted the theory of comparative advantage), and Harry Johnson all made their errors. Few people

who argue that complete harmonization will occur have shown any sign of being aware of the relevant theory and evidence, let alone of feeling any obligation to refute it.

The Canadian Identity

A number of people have argued that the agreement places at risk the very basis of the Canadian identity. I believe that the Canadian identity is more deeply rooted in our history, our geography, and our immigrant experience, than these people accept.

The European Community is a vastly tighter association than anything ever contemplated between Canada and the United States. It was born out of the ashes of the Second World War by Europeans who saw it as the first step toward political union. It calls for a great deal of harmonization of social and economic policies. Yet the Danes, the Dutch, and other small partners have maintained their national identities within the tight confines of this community.

The European Free Trade Area was formed by those peripheral countries that wished to avoid the harmonization pressures of the EC, but that also wished for free access to a large market. EFTA is just that: a free trade area without any of the explicit harmonization pressures set up by a common market. Each EFTA country has a free trade agreement with the EC as a whole. Sweden, for example, trades freely with the EC. While managing to maintain its generous social policies, Sweden has also maintains its distinctive national identity and pursues its own industrial policies.

Ireland and the United Kingdom had a much tighter union than any contemplated Canadian-U.S. scenario. While sharing a common language and culture — both being occupants of the British Isles — neither country encountered any of the losses of culture or national identity that some Canadians worry about.

I do not see, even in the wildest stretch of my imagination, that one of the issues we Canadians face concerns the giving up of our identity. Some prominent politicians have suggested that rejecting the agreement is the price of staying Canadian — a price I would pay without a moment's hesitation, if I thought that were the real choice. Those who hold this view, however, have an obligation to explain what there is about the agreement that threatens Canada's national identity or political sovereignty. I find it hard to perceive reasoned arguments behind these assertions.

The Slippery Slope

Another often heard argument is that a free trade agreement will lead to a customs union, which will lead to a common market, which

will lead to a political union. I know of no body of either theory or evidence that supports this "slippery-slope" hypothesis. Like most of the bizarre suggestions people purport to take seriously, one can only ask "why?" If you tell me that talking to a guy with a long nose will give me a long nose, it is not for me to refute your assertions, it is for you to give me one plausible reason why I should take such apparent nonsense seriously.

Even where it was desired by the participants, this evolution from less tight to more tight arrangements has not proved inevitable. The political forces tend to push the other way, and a real effort of political will seems to be necessary to turn any of these associations into a tighter, more comprehensive, one. The founders of the EC hoped that the economic forces of harmonization would force political union in spite of national resistance. It did not turn out that way. The evidence is that, unless we try very hard, the CAFTA will stay just that, a free trade area.

So it seems to me that we have struck a pretty good bargain. We gave up our policy independence over a number of nationalist measures, such as reviving FIRA or the NEP, that have been discredited. We got a classic free trade area plus (the plus including services), and we got a concession of great importance from the United States in their acceptance of a binding dispute settlement process and binational review of their application of their own trade laws. We got a commitment to negotiate better trade laws in future.

It is difficult to assess the benefits of the dispute settlement process, but we heard at this conference that the proposed agreement could head off trade cases in energy and automotive trade. Those are tangible benefits of great significance to the Canadian economy. There are no additional constraints imposed by the CAFTA on Canadian subsidy or industrial policies, but we obtained some limits upon the potential encroachment upon Canadian policies resulting from unilateral abuse of the U.S. trade laws.

Nationalists tell us that Simon Reisman sold out the shop. A stronger case could be made that that wily old negotiator traded a bunch of empty Canadian policy boxes for some boxes well packed with U.S. goodies — we have given up our right not to shoot ourselves in the foot by a return to nationalist trade and investment policies in return for much improved access to the U.S. market and an impartial referee for trade disputes.

Discussion

Robert Stanfield

Thank you very much, Professor Lipsey. I realize that time has been marching on, but I feel a little responsibility in connection with this debate, partially because, of course, I've spent many years in legislatures when debates are finely focused and everything is thrashed out very pointedly in the end. What we're really supposed to be debating here is the question of sovereignty. And when I say that, I'm not criticizing anybody, any of the participants who went a little farther afield. But Richard Lipsey made a very emphatic statement in the course of his remarks. He suggested that reducing the tariffs between the two countries by a relatively small amount couldn't have very much effect, in itself, on our sovereignty.

Gerry Caplan addressed the sovereignty question directly at the outset, and he spoke as if what was being done would, in fact, expose the country more to American values, American ways of doing business, and so on. Now who is right? I would like to ask Mr. Caplan very briefly to reply to Mr. Lipsey's statement that the proposed tariff reductions will have very little effect on our sovereignty in the sense in which he addressed it.

Gerald Caplan:

If the question is who is right, there is little doubt about that, I think. That takes care of that question. I think Dick Lipsey said that a 5 per cent tariff change won't make us grubby materialists overnight. I didn't suggest for a second it would. I suggested that if we tie our future more organically to a North American economic system, it will become more difficult to have control over our own choices.

Precisely the issue that I underline is the choice between a market-driven economy and an interventionist economy. And precisely the point I made is that we will be more closely tied to the U.S. economy and to the U.S. political economy, which frowns on interventionism and on the kind of tripartitism which, it seems to me, holds a reasonable future for Canada. Although I'm not at all convinced it can happen, the kind of deal proposed will make that kind of interventionism less possible. It's not a matter of exposing our kids to Miami Vice, it's not a matter of 5 per cent tariff changes; it's a matter of the organic change. And because of that, I think the agreement should be defeated.

Robert Stanfield:

You make the point that tying ourselves closer to the American economy makes intervention more difficult. Is your basic point that we, in fact, have a good alternative available to us to avoid getting tied more closely to the American economy?

Gerald Caplan:

I don't pretend there are any easy solutions to a whole series of structural Canadian economic problems. I know there are all kinds of political platforms, but implementing them is difficult and the complexity of it is often under emphasized. I don't mean there's no alternative at all, although the pro free trade people have often asked the question, what's the alternative? In part it's what Abe Rotstein says, that the alternative is trusting GATT more. But I want to repeat the proposition for a kind of tripartitism. I think that makes sense in a Canadian context, but I cannot tell you that it will ever happen in Canada. I can't tell you that the structures of the Canadian labour industry and government could ever function in the way they have in Sweden and in Austria. But if I had a choice, I'd rather try that and lose than get sucked into a North American vortex from which there is little escape.

Robert Stanfield:

Thank you. The reason I pursued this is simply because I've gone to so many conferences, particularly in the days when we were discuss-

ing the Constitution, where people would come and state their views, they would never come together, then they would come back two weeks later and have the same discussion.

Richard Lipsey:

My position is that, on efficiency grounds, we must mainly rely on the market; and we've given up nothing that I can conceive of wanting to take back. A free market in energy, and a reasonably free market in investment, are the facts of the world today. What I want to maintain is the right to have redistributive policies, social net policies, of a much more imaginative sort than we have now. I know of nothing that Sweden does that would be precluded by the free trade agreement we have with the United States. I don't think anything Sweden does, that would make sense as social policy, would be precluded by the agreement that we now have.

Robert Stanfield:

Thank you. We want to finish. Now don't be too provocative, or we'll be here all afternoon.

John Crispo:

I want to look at the reverse side of what Dick Lipsey said about sovereignty, because nobody mentions it in this country. To me, one of the greatest things about this agreement is that we will no longer have to appear before all those hearings of the International Trade Commission or the Department of Commerce as a supplicant, begging and grovelling and saying, "Please make an exception for Canada," or "Remember the hostages in Iran". It has been so demeaning and degrading. Now, subject to the fine print, we have a system in which we are a partner. We have an equal voice and vote in the final determination of whether there has been a violation of countervail or dumping laws. Incidentally, their laws are not all that different from ours. The issue is the dishonest way — and that's the only word for it — in which their laws have been administered and interpreted.

I want to say something complimentary to Gerry. At least he is honest enough to stand up and say that he is an old-fashioned Swedish social democrat. In effect, he is saying that he opposes this

deal with the United States for ideological, philosophical and political reasons, and because it is going to reduce the prospects of being able to socialize Canada. That's a legitimate and logical position for him to take. I wish you could get Ed Broadbent to take the same position, let alone Bob Rae; he won't even admit he's a socialist. I wish you could get Ed Broadbent to get up on national television and say that that's the real reason. But he's got too many political smarts to get up and say that, because he knows it wouldn't sit well.

One quick reply to Abe Rotstein's comment that the United States is getting a 10 per cent reduction, and Canada is only getting a 5 per cent reduction. That's so simplistic. Why don't we say that we're getting a ten times bigger market to exploit, and they're only getting one-tenth more?

Abraham Rotstein:

John, you must have been dozing in the other half of my text. I said if the issue was tariffs we should go for it. If we clear up tariffs once and for all and finish the last round in the historical process, all that is left hanging is the Auto Pact, and we may disagree on that. Don't leave the impression that anyone here is in favour of relying on tariffs. But a whole new ball game has started.

We have this extraordinary list of concessions that we are making in the area of non-tariff barriers, which we don't know how to deal with, which are very difficult, and which can't be treated in the usual way, as I pointed out. I think this is simply an unbalanced deal. We hear that this is for our good; for example, that the oil agreement with the Americans is just for our own good. And we hear a kind of regional racism, about Ontario in its arrogance being against Alberta and against the east.

This is nonsense. Alberta's petrochemical industry depends on cheap gas, and, although I am not an expert in this particular area, I think we want to keep our options open. Energy, if you'll forgive me mixing metaphors, is a minefield. We don't know where shortages are going to come from, we don't know where prices are going to go. We don't want to have our hands tied; we don't want the Americans to have an implicit ownership of 90 per cent of what we've got. It is nonsense that this is what we wanted all the time, and that everything we've given the Americans in this free trade agreement is (a) good for us like cod liver oil; (b) is what the market really wants; and (c) is good Canadianism.

Some have argued that the real assurance of greater sovereignty and a more flourishing culture comes from a more prosperous economy. It is a line from the 1960's, propagated particularly by the late Professor Harry Johnson. He used to say "There's no one as independent as a man who can pay his own cheque".

If that were true, you would think that with our recent \$20 billion trade surplus, we should have had a terrific culture with all kinds of successful T.V., radio and book publishing programs in place. I think it is simplistic and naive to draw that kind of parallel. The notion that "good business proceeds give you good culture" simply doesn't make any sense. It doesn't relate particularly to the kind of culture problem that we have right now.

I think you have all seen the references to the fact that Americans were going to "solve Jack Valenti's problem". And that has a good deal to tell us about the nature of the cultural pressures that are going on. Jack Valenti rules the roost, in terms of Hollywood and the film distribution system in Canada. I think Marcel Masse made the correct observation two years ago at the start of the free trade negotiations. He said if we're ever going to get free trade in this country, we have to establish a firm, operative, and working cultural policy. When he was the Minister in the Department of Communications, he tried very hard and was quite successful at it. With Flora MacDonald, it looks quite different. First, she announced the prospect of a film distribution bill. But one can't know what goes on in Cabinet. She has now put the bill on hold while the free trade negotiations are going on. I feel the government has turned around on this issue. It is one illustration of the jeopardy in which cultural policy has been placed.

Finally, the question of sovereignty. The issue is usually put as follows in the free trade camp: Can you give me an example of any other country that got into a common market, that lost its sovereignty?

I think this is a naive approach to the question, that either you have sovereignty or you don't have it. But it is not an all-or-nothing matter, not a single discreet phenomenon. This view does absolutely no justice to the nature of what everyday life consists of, or how our communications apparatus works. Do people have a chance to hear each other from coast to coast, in channels that are not cluttered with tidal waves of all kinds of "noise"? The question of sovereignty is not an "all-or-nothing" proposition, it is a matter of degree! It is a matter of skillfully worked-out cultural policy, an attempt to follow up, for example, Mr. Bernier's figures that Canadian films are about 2 per cent of the total shown, books about 18 per cent. Intelligent policies

with help from various types of subsidies can create a few channels, even if they are subsidiary channels, where Canadians can see and understand and listen to each other, before we get totally swamped by the overflow of U.S. media.

But, we would have to swim upstream against the reigning ideology of "free markets" in everything and would necessarily infringe on American business claims in this area of "cultural industries". The free trade agreement leaves much of this in an ambiguous status.

Robert Stanfield:

We're getting a pretty good idea of what the differences are. People on the panel are talking about the same issues I believe. We are here to talk about sovereignty, and the effects on sovereignty, and I think we're getting a pretty clear view of the different views of the members the panel, on the subject.

Harold Millican:

Mr. Chairman, I'll be a little bit rambling. First of all, there are not too many western Canadians at this forum. I think that those of us who are here have experienced, without question, a very broad ranging, tremendous forum. It's too bad, and it's really a crime in our modern society, that the press cannot present the issues to the nation in the balanced way the participants here have presented them to those few of us who have been able to observe these proceedings.

I must say that I am absolutely amazed and delighted at the remarks of a man of Dick Lipsey's prominence and profile. Quite frankly, Mr. Stanfield, this is the first time in my life that I've heard someone from central Canada acknowledge the energy situation as we in the producing provinces see it. I don't know to what degree Mr. Lipsey will be able to tip the balance over time. I would be remiss as a person from a producing province if I didn't at least remind this audience that, over our recent history, we have been subjected to a two-price system. There isn't any question, and it's been said before, that Alberta, Saskatchewan and British Columbia forfeited up to \$60 billion worth of revenue, which is the difference between what they received for their non-renewable natural resource and the international price. We have had only a million dollars back, to buy tractors and four-wheel vehicles for the agricultural industry, as

alluded to by one speaker this morning, along with a little bit of temporary relief for the oil and gas industry of late.

I want to remind all participants here that a healthy oil and gas industry leads to a healthy industrial heartland. Our purchasing power in central Canada has diminished over the last few years; but when you look at what goes into the oil and gas industry, and what we buy in the form of vehicles, diesel power units, pipe, cable — and on and on the list goes for the oil industry alone, not counting what our consumers buy — you realize that a healthy oil and gas industry leads to a healthy Canada. We are quite prepared to live with deregulation as it has now been invoked, and take its abuse, if that's what it is, on the downside. But we feel, without question, that we are entitled to the upside, if and when it comes, as a result of growing demand. I think all Canadians have got to realize this in the interest of fairness and equity. Ours is the one commodity that has been restrained from international pricing. Everything we buy, from the examples given to everything else — stoves, refrigerators, automobiles — we buy at the Ontario price. Professor Lipsey, I really appreciate very much that you took this opportunity at this time to call for fairness before such an auspicious audience.

Robert Stanfield:

Cherish the moment.

Ted English:

Mr. Chairman, I'd like to second what we just heard about the value of this whole two-day exercise, and about the opportunity it gives for facing the realities of a controversy, as well as the substance of the issues that we are concentrating on, yesterday more particularly. I think it has been a time of true confession, also. We have Ron Wonnacott admitting that he is an interventionist. Dick Lipsey, at least once, said he was a social democrat, and he probably still is a John Stewart Mill enthusiast. As for me, at one time I was a believer in protectionism. It wasn't a question of ideological conversion; I wrote a thesis and the facts convinced me that I was wrong, and that's where I've been ever since.

So I've tried subsequently to make my tendency to be interventionist on some matters compatible with the belief that, if we are

going to have an effective economy we have to find this kind of solution in our North American context. But I wish to address some of the mainstream ideas of the panelists who disagree with me, probably on the main point.

Let's take a look at this business of being too close to the United States. I think that it's possible to be too close to the United States in this sense: if the Canada-U.S. arrangement should lead to our preoccupation with North America, then this would be the greatest loss that would result from this particular exercise. I am going around preaching these days that our government, and, if possible, our opposition — although there doesn't seem to be much prospect of that — and our political leaders make every effort to demonstrate that this bilateral arrangement is compatible with and conducive to a more effective multilateralism. I can speak about this for half an hour, but I know the Chairman will not permit me. But I believe intensively that we need to get on with bringing together some of the conflicting political positions in this country.

On Abe Rotstein's position, I think there's one important point. He referred to the fact that we had not been able to improve our culture, even though we had a \$20 billion surplus. Of course, if you are talking about a surplus on the trade account, you are suggesting we should improve our culture by buying from the United States or somewhere else. I think the point you should be alluding to there is that what has enabled us to improve our culture is a higher GNP, not a trade or current account surplus, and there is evidence — plentiful evidence in the 1960s and early 1970s — that we did precisely that with our very rapidly growing GNP. We put in place our major social welfare programs, which we now regard as a significant feature of Canadian identity, and we also spent a lot more money than we seem to be able to do now. Prescriptions for growth in our GNP are of major importance in ensuring Canadian culture, which we must all seek to do.

Douglas Brown:

I work for the government of Newfoundland, but I am not necessarily representing the Newfoundland government's view. I think some of the discussion here this afternoon has helped me to make some distinctions between cultural industry and cultural sovereignty, and what I think is more properly called economic nationalism. I think some of the panelists here probably represent the views of

economic nationalism. I come from a part of the country where, as you know, culture is more in terms of, I suppose, a way of life and the way people do things and the way they feel about work and families, their communities and their religion and so forth. Newfoundlanders gave up their sovereignty in 1949 to go into a bigger cause. They gave up all their economic nationalism.

Robert Stanfield:

Don't exaggerate, now.

Douglas Brown:

Well, our position on northern cod notwithstanding, we gave up some of our economic nationalism for the greater Canadian cause. I think that when we consider culture and how to preserve culture in this country, we have to consider the other part of Canada that is not necessarily visible from this august city. And that is the rural part, the small towns, the mining communities, the fishing communities and these places where people pursue their own way of life. The vast majority of these communities and their entire way of life is very dependent on international trade. A good illustration of how a cultural change has made a society more in favour of freer trade is what happened in Quebec, where people turned around and said that they want a part of the financial and economic life of this country, and are keen to be part of it. It has made them turn from being narrow nationalists into internationalists. I think this is the perspective that we take in Newfoundland as well.

Robert Stanfield:

I think we've had a pretty good discussion. I think much of the discussion has been right on. I don't mean that we have reached agreement on everything, but at least we have put it out on the table and we have been able to follow the cases being made by those who differ. I would like to thank members of the panel again, for their patience with me, and I thank the audience.

VII
Conference Summary

Conference Summary

Rod Dobell

This session is advertised in your program as a conference summary. It's clear from all the discussion thus far, that a conference summary is not easily to be obtained. But, in part, the feeling was that with the advantage of chairmen such as Robert Stanfield, Jean-Luc Pepin, and Gordon Robertson, we should not leave without having a few remarks from them on their impressions of the sessions which they chaired and indeed, any further reflections that those impressions might stimulate. Rosalie Abella, unfortunately, was not able to stay through the afternoon and participate in this session, but we are proceeding, in any case, with the three gentlemen you see in front of you.

Gordon Robertson will lead off. Mr. Stanfield will follow, and Mr. Pepin will pick up the comments that the previous two left unsaid. It's putting people somewhat on the hot-seat to ask them to follow a discussion as lively as the previous discussion and extract some simple threads from the intricate sets of commentaries that we have heard thus far. But these folks have all been in various kinds of hot-seats before, and they have agreed to take on the job. The first speaker then, is Gordon Robertson.

Gordon Robertson:

I am glad, Mr. Chairman, that you dispensed with the idea that this session is to be any kind of a summary. It would require not only rashness, but courage, to try to summarize that last session. I wouldn't be prepared to venture a try, let alone to offer a summary of the conference as a whole.

As far as the conference itself is concerned, the first thing that I would like to do is congratulate the Institute for Research on Public Policy, and Murray Smith in particular, for having organized it, planned it, and structured it. Your reaction proves my point. I think it has been an excellent conference, and, as far as I am concerned, a first-class learning experience. I have learned a great deal about the issues involved in the trade agreement, and I suspect that other participants have had exactly that reaction.

I came to this conference with a general sense that, on the whole, the free trade agreement sounded like a good thing, and advantageous for Canada. But I did not know enough about how it would work, what the issues were or how the total balance of advantage would fall out. I have been persuaded that as far as the economic aspects are concerned, the advantages substantially outweigh whatever disadvantages there may be in the prospective free trade agreement. I have also come to the conclusion that those economic advantages very considerably outweigh whatever risks there are — and there are risks — in connection with the non-economic aspects of its effect on Canada in the future, if the free trade agreement goes through.

I found Gerry Caplan's comments very persuasive about the Canadian tradition of interventionism by government in order to promote social purposes that we consider desirable. I would hope that we will be able in future to have a continuation of that tradition, and I see no reason why we cannot, within certain limits. There will undoubtedly be limits, but I suspect that most of those limits are now likely to be more financial, because of limitations of government capacity to spend, than they will be consequences of the trade agreement. Financial problems will impose limitations on political programs. That is the influence we are likely to see, I think, rather than the consequences of what some referred to as "inexorable drawing together" with the market-dominated society of the United States.

And while I don't have the capacity for colourful expression that Richard Lipsey has, I share his comment when he said he has "seen governments and bureaucrats screw it all up". I have been in the public service a long time, and I have seen both. If I had a higher regard for the certain wisdom of either the political or the bureaucratic level, I might have more apprehension about whatever limitation there is or may be, because of the trade agreement, on the capacity for government interventionism. Since I do not have that high a regard for the inevitable rightness of government policy, I am not too much deterred by whatever diminution there may be, and I think it's going to be slight, in our capacity to carry on our tradition of

government intervention for social purposes to the extent that we may want and will be able to afford it.

Having arrived at the conclusion, after two days at this conference, that the free trade agreement is, on balance, a good thing and would be desirable for the country, I set myself to considering what are the prospects that it will be brought into effect. I have arrived at the conclusion that Rodrigue Tremblay articulated this morning. He said that he wouldn't be prepared to bet that the free trade agreement is going to go through. That exactly is my conclusion. I think it is worthwhile thinking about that a little bit — both those in favour of the free trade agreement and those opposed.

Assuming for a moment my conclusion that the free trade agreement is on balance a good thing, why do I think it's going to be nip and tuck whether it will go through? Before hearing Richard Lipsey, I had sorted the reasons out into six points. He added one more for me. The six as I had them down in my notes were:

1. The free trade agreement, as I see it, in economic terms presents the certainty of injury for some people and some industries on the one hand, versus hypothetical benefits for unidentifiable people and less certain industries on the other. The certain injuries will come soon; the hypothetical benefits will come late. This is going to make the pain more specific for the people who are hurt, than the benefits are for the people who are going to gain from the free trade agreement. In short, the disadvantages will be more present and obvious, and the consequences far more articulate than the advantages will be.
2. The second point, and this, I think, is perhaps the strongest of them all, is the great emotional deficit on the "Yes" side of the argument. It is very easy, as we have seen this afternoon, to become strongly emotional about the Canadian way of life. Canadian identity and Canadian culture. Another source of emotion, although it is not stated — I think it is under the carpet in a number of cases — is anti-Americanism. These emotional aspects are almost all on the "No" side. There is very little emotion on the "Yes" side: it is a calculus. Emotion is a very strong force that will move people when a hard economic calculus will not.
3. The third factor, it seems to me, is Canadian history and experience. These can be appealed to and will be appealed to. They are almost all, I think, on the "No" side. First of all, in terms of economic policy, was the "National Policy" of Sir John A. Macdonald. It was a protectionist policy under which Canadian industry grew and succeeded. The second important part of our

history, in economic terms, has been referred to several times: the rejection of free trade in 1911, when the Laurier government negotiated and brought it forward. And the third important part of our economic history in this regard is the whole tradition, since the Second World War, of the multilateral international approach to economic adjustment, treatment of tariffs and establishment of rules for international trade. That has worked very successfully. A good deal of the Canadian prosperity and increase in economic efficiency and trade has been based on that post-war multilateralism. We are, in a sense, being asked to go against those traditions of Canadian history and Canadian policy in adopting a bilateral free trade agreement with the United States.

4. The fourth consideration is, as we have seen this afternoon and this morning, the strong ideological opposition that there is — and it is a valid opposition, by certain groups in the country. The trade union movement is strongly opposed: Jo Surich articulated its views very well. Gerry Caplan, this afternoon, stressed the value that, for strong philosophical reasons, is placed on government intervention for a whole range of social purposes in Canada. These are ideological principles. They are strongly held by many and will be strongly articulated.
5. The fifth, a current counter-action, is one that has arisen in the last couple of weeks — the American economic and financial problems. I refer to the stock market crash, the problem of the American trade deficit and the rapid decline in the value of the American dollar. The instinct of Canadians will be to draw back, to argue that those problems warn us not to do what a free trade agreement would do — tie ourselves more closely to a troubled United States. I suspect that that instinct is precisely wrong. The American problems will almost certainly lead to an increase in protectionism and other measures designed to cope with the critical double deficits and probable recession. If so, the wise thing is to have a negotiated arrangement with the United States under which we are not at the mercy of this surge of protectionism, as we would otherwise be. I think, however, that the contrary instinct will be there. The appeals will be strong and apparently convincing that we should not get more closely involved.
6. And the sixth point that I had was the general human reluctance to change. As Shakespeare put it, "We'd rather bear those ills we have, than fly to others that we know not of." That is the way that most people react to significant proposals to change their way of life.

Those are the six points I had as reasons why the free trade agreement is going to have a very rough time. As I said, Richard Lipsey added a seventh this afternoon, when he referred to the media handling of comments that are made by people who often don't know much about the free trade agreement. The attention they get in the press contrasts with lack of attention to Don Macdonald, Simon Reisman and other people who talked yesterday to this conference.

So, to be brief, I think the free trade agreement is going to have a very rough time indeed. Like Rodrigue Tremblay, I wouldn't want to put any money on its success. And for any who think that the free trade agreement is important for the Canadian future, I think the moral is that a great deal of work is going to have to be done, and it will have to be very effectively planned, or it is not likely to succeed.

The other thing that has struck me is that the political situation and the constitutional process in Canada may expose the whole agreement to further hazards. I referred briefly, in response to a question yesterday evening, to the constitutional position. I said that, while no legislation is needed to approve the agreement as such or to enter into the agreement, and while there is no legal requirement for any approval by Parliament at all, the constitutional convention is to have a resolution of approval for a treaty of importance by the House of Commons and by the Senate. The agreement is not technically a treaty, but I do not think the precise form is the significant thing; it depends on the importance of an international commitment. No problem in this case about the House of Commons, but what about the Senate? There is a substantial Liberal majority in the Senate. The leader of the Liberal party has not only declared his and the party's opposition to the free trade agreement, but has said that if a free trade agreement is entered into, when he comes to power, he will see that the trade agreement is torn up. In those circumstances, is the Liberal majority in the Senate going to vote in favour of a resolution of approval for the free trade agreement? I think it is most unlikely.

What are the other possibilities? The Liberal majority could defeat a resolution of approval that comes to the Senate. If it defeats a resolution of approval, the government could go ahead anyway, sign the agreement and proceed; it's only a constitutional convention that it requires a resolution of approval, not a legal requirement. But this would be a pretty unsatisfactory and hazardous way for the government to go ahead. Another possibility, if the Senate defeated a resolution of approval, would be for the government to decide that was a very good issue for an election, and to go to the country, not just on the free trade agreement, but on the agreement plus the undemocratic conduct of the appointed Senate in opposing a matter of such fundamental importance approved by the elected House of

Commons. I suspect that this might very well be the way the thing turns out.

To add it all up, it seems to me that, while the free trade agreement has emerged from these negotiations, and while, if my assessment is right, there is an important balance of advantage in seeing the free trade agreement go through, we are only coming to the beginning of the real hazards. It is going to be quite a contest before we see the end of this struggle.

Well, Mr. Chairman, with those comments I leave my parting thoughts about the way ahead for the free trade agreement.

Rod Dobell:

Thank you very much, Gordon. The image of the Senate as the Liberal party's instrument for bringing about the election on the free trade issue is a fascinating image, one that had not occurred to me.

Robert Stanfield:

We are involved in a fascinating topic. I'm out of politics — I've been out of politics for some time — so I have even some temptation to start to think about things. I'm sure you would never expect me to express an opinion on anything. After all, you would say to me, you never did that when you were in politics, so we don't expect you to do it now. The forum I was chairing this afternoon had a fairly narrowly defined topic, relating to the effect of the proposed agreement on our sovereignty. We had a good head-on discussion with respect to this.

Mr. Caplan clearly felt that he doesn't like the idea of our Canadian economy being tied more closely, or tied perhaps as closely as it is, to the American economy, because of the pressure this would put on the formation of our future cultural values or even on our present cultural values.

Professor Lipsey, on the other hand, felt that the tariff reductions involved in this deal would have a marginal effect on our values. I didn't think he was entirely clear about what effect the deal would have on our ability to intervene in the economy; that is, the ability of Canadian governments to intervene in the economy. But, they — Gerald Caplan and Richard Lipsey — along with Professor Bernier and Professor Rotstein, put the issue pretty clearly on the table for us to have a look at.

Professor Rotstein went further. He analyzed the agreement and found that if it were just tariff concessions by themselves, he wouldn't be impressed very much; but he'd say, go ahead and take them. But other aspects of the agreement made it less than useful to Canada.

There we are. I think the issue of the effect on our sovereignty will be very much before the Canadian people for the next while. It's something that a lot of Canadians, if not all, will want to think about pretty carefully.

If I had my druthers, if I had a choice, if I felt I had a choice — a choice that would fly — this would not be it. I have felt for a long time, even before I got into federal politics, that it was imperative for Canada to have relatively tariff-free access to large markets, at least in sectors. Of course, that's the easy way to go. I would have preferred to have a sectoral agreement, like the Trudeau government tried to bring about in the early '80s; but the Americans said they weren't interested in it. I would have preferred, too, the third option — Mitchell Sharp's third option of the early '70s. If it had worked, it would have given us a broader base in Canada. We wouldn't have all, or so many, of our eggs in one basket. That would have been the more attractive alternative to me than simply a free trade agreement with the Americans.

Multilateralism? Is multilateralism a significant alternative for us in Canada today? Are Canadians really prepared to face up to another significant round of GATT, involving significant reduction of tariffs on goods coming in from the Third World? Are Canadians who are concerned about American competition going to be content to accept more Third World competition? I'm not sure of that. And I have the feeling — I don't want to be small about this — but I have the feeling that many Canadians who are now saying the way we should be going is the multilateral way are saying the easy thing. It's not the alternative before you. I would be interested in seeing some real demonstration, on some basis, that Canadians would be prepared to go that way if this agreement were to fall flat for one reason or another. At the moment, I'm not at all confident that the Canadian people would accept significant increases in competition from people living in the Third World and receiving very low wages. I may be wrong on that; I just mention to you that it's one thing that concerns me.

Now before I sit down, there's just one aspect of this agreement and its circumstances that has been of interest to me for quite a long time. That is with respect to my native province, Nova Scotia, and the other provinces down there. When I was Premier there in the '60s, and Henry Hicks before me, and Angus L. Macdonald before that, we

accepted federal aid very willingly. It gave us a chance to jack up our educational system and do many things. But I think Nova Scotians in those days looked forward to the day of working up to a position of parity, some kind of parity, with the rest of the country. I don't think that's the way DRIE worked out. I think DRIE perhaps increased incomes to some extent, but I think the judgment that the Atlantic Provinces Economic Council expressed in the late '70s, was that it also greatly increased dependency.

I ask myself — and I haven't got the answer — whether an agreement like this offers the people of Nova Scotia an alternative to dependency on central Canada, economically, for grants, and so on. I'm very well aware that free trade was the old Liberal solution to disparity; that strong conviction existed among people I refer to as old Liberals, who were the leaders of opinion in Nova Scotia in the old days, that this was the only answer and otherwise they were going to be exploited by central Canada — on the basis that Nova Scotia couldn't compete equally with central Canada for markets in Ontario, Quebec or the west. I sort of hope that Nova Scotians and New Brunswickers will ask themselves whether this is an alternative to dependence. I don't say it is. It may not be. But it seems to me, there is very little future, very little satisfactory future, for the Maritimes under the existing set-up of trying to serve the Canadian market and taking hand-outs. About a year ago I raised the question of whether this deal would not give Nova Scotians an opportunity to take a decision that would be perhaps the most important they had taken in their lifetime. It was important, I suggested, for them to get it right. It's a hard decision. They may be better off the way they are. But I think if that's true, it's a pretty dismal future for that part of the country unless they strike oil in a big way.

Jean-Luc Pepin:

I have not reached a conclusion yet, for or against, the Canada-U.S. Free Trade Agreement. I am still agonizing over it. Why?

First, because I have to agonize when given a good opportunity to do so! Second, what better subject is there to agonize on than this agreement which will affect most aspects of Canadian life for centuries to come? Third, we received the ABCs of the agreement only three weeks ago and the final text is still to come. It might be wise to reflect further before jumping.

I really want to make only two points today.

Notwithstanding my admiration and respect for the United States,

I cannot wash from my mind the memory of many Canada-U.S. negotiations in which I have been involved — on energy, on trade, on grain, on air transportation, etc. Time and again U.S. negotiators would agree with our own, but time and again they would back away with the excuses "Congress will not understand", "Congress will not agree". I am not comfortable with the idea of leaving too many Canadian eggs in congressional hands. Some commentators said yesterday that the mechanism for the resolution of conflicts in the agreement supports the rule of law as opposed to the rule of Congressmen. As I read the agreement, there is no supranational authority. The national laws still prevail. Binational panels will only comment on how the laws have been interpreted.

More deeply still, I am concerned about what can happen to Canada as a political entity. Most people push this fear aside: "Look at the amount of integration we have now with the United States," they say, "and admire how much political independence we still have".

My reasoning runs differently: Look at how much cultural, military and economic integration we already have with the U.S.; look at how much we are about to acquire and try to foresee how much more integration will inevitably follow the free trade agreement. Somebody said yesterday that he expected the speed of integration "to accelerate". To me that is part of the law of nature!

Another speaker said in opposition: "You can have a lot of economic integration without political union. Look at the European Economic Community: France is still France, England is still England." Yes, it may be that political integration is not taking place in Europe as rapidly as anticipated. European cultural roots are deep. There are more political units involved, units of a different size, with various interests. In the Canada-U.S. one-to-one embrace, our shallower cultural roots, and their greater attractiveness and absorptive power will make the process of political take-over easier here, I think, than in Europe. I like the status quo!

Rod Dobell:

IRPP's purpose in organizing this meeting, as I think the Chairman of our Board said in opening it, was to stimulate some serious scrutiny of the proposed free trade arrangements, some close sceptical examination of such texts as are available now. I hope you feel that purpose has been accomplished. Certainly the importance of the topic demands no less.

It seems to me that the discussion here has resolved to some extent some of the differences in perception that Rosalie Abella referred to. We've recognized that the dynamics of economic relationships in an interdependent world, with rapidly changing technologies and rapidly spreading institutional linkages, forces some integration of our economy with others, whether we will it or not. We've recognized that that process is going on now, and leads inevitably both to a need for continuing economic adjustment, and to some limitations on the scope for individual nations to pursue independent economic policies. But there is a question of how much of that integration of the Canadian and U.S. economies has to be accepted as a consequence of changes which are simply beyond our control, and how much more we are going to accept — or, indeed, encourage — as a result of decisions with respect to trade, tariffs and more particularly, non-tariff barriers.

It seems to me that we could almost leave here agreeing that in this debate it is not a question of who's a free trader and who is not. It is also not a controversy about moving the last small steps toward removing remaining tariff barriers, or fearing a marginal increase in the U.S. share of Canadian trade flows already overwhelmingly dominated by the north-south traffic across the Canada-U.S. border.

Nor is this debate really, at its heart, about whether the long-term economic gains outweigh the short-term pain of dislocation. It wouldn't be quite true, but I think it's almost the case that if the proposed deal with the U.S. were only the deal on tariffs, or on elimination of obvious protectionist barriers to free trade, we would probably all go away saying that's acceptable, even welcome, as Abe Rotstein hinted. We might even go away saying that if all these disciplines that are supposed to be good for us are indeed accepted as good for us, then we could take these tariff reductions and related measures unilaterally, in our own interest, without having to make undesirable concessions to the U.S. to buy their acquiescence in reciprocal cuts.

The issue thus is focused not on the question of whether we gain a lot by going the next step in reducing tariff barriers, but whether, as a basic political decision, we want to go some significant further steps in the integration of the Canadian economy with the American, toward what at least some American observers see as a continental common market.

I take away from this discussion the feeling that there are two leaps of faith on which one has to make judgments before knowing

whether to come out as a supporter or an opponent of this proposed agreement. One real leap of faith is the conviction that one can nestle in under the wings of the great southern eagle, and bind ourselves through that mechanism into greater market disciplines, without thereby generating what I think Ted English called an "unhealthy preoccupation" with the United States, or without what some speakers this morning hinted would be a possibly undesirable concentration of U.S. ownership of the Canadian economy (as opposed to foreign ownership more generally), or without undesirable pressures forcing conformity with U.S. values in foreign policy as well as domestic social policy. That's a question that one has to face. And one can answer it, it seems to me, listening to the speakers today at least, in very different ways. But it is a judgment that has to be made, and it is a judgment on which people legitimately can hold different views and hold them very deeply.

The second question, it seems to me, is not one of continental integration as such, and the consequences and dynamics of that process, but rather a question of feasible strategies in pursuit of domestic social policy. Can we have faith that we can, through this proposed Canada-U.S. agreement, bind ourselves to desirable market mechanisms and outcomes, tie ourselves into market disciplines which are appropriate in pursuit of an efficient economy, and then, subsequently, build up the global redistribution policies that Dick Lipsey referred to, or the active manpower policies along the lines of the Swedish model, that would make socially acceptable the market outcomes generated by that type of free market discipline?

This is a question of political economy, of what is feasible in the contemporary Canadian context. Its answer goes to the heart of the question whether this proposed agreement would submit to American review too many of the instruments of economic policy we might wish to preserve as tools to civilize market mechanisms.

It's possible, I think, to answer that question also in two different ways. My hope for this meeting is that we really can see — several speakers have said it in the course of discussion, and it seems to me to be a major accomplishment if it is true — that views on questions of that sort, views on the political decisions, rather than the economic calculus involved in this proposed agreement, are views that can legitimately be held differently, by different people, in light of very different visions of the country. If that's been accomplished, then certainly some clarity has been brought to a discussion that we've all said has been unduly coloured by too much not very productive sloganeering.

I hope this has been as fascinating a meeting for you as it has been for me. If so, it remains for me only to thank Murray Smith, Lynda Lennon and Marina Horrocks, and all the others who worked so hard in putting this meeting together. Let me, on your behalf, thank our chairpeople and panelists, and let me also thank you for your participation and your contributions to this discussion.

Thank you all very much; we'll stand adjourned.

VIII
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Edited by MURRAY G. SMITH and FRANK STONE

The Free Trade deal reached with the United States, on October 4, 1987, has provoked intense debate among Canadians. In October 1987, the Institute organized a two day forum in Toronto to examine the proposed Canada-U.S. Free Trade Agreement and to debate the implications for Canada. Ambassador Reisman, Canada's chief negotiator, and the Honourable Donald Macdonald, explain the agreement and trade specialists, lawyers and economists analyze succinctly the elements of the agreement. The Honourable Pat Carney, Minister of International Trade, and the Honourable Grant Devine, Premier of Saskatchewan, lead off a debate among labour leaders, academics and policy analysts about the implications for the Canadian economy and the consequences for Canada's sovereignty. The proceedings feature frank exchanges among Canadians with differing perspectives on Free Trade.

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